THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

THE BERKSHIRE GAS COMPANY	**)))**	**D.T.E. 01-56**

REPLY BRIEF

OF

THE BERKSHIRE GAS COMPANY

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I. STATEMENT OF PROCEEDINGS

In accordance with the procedural schedule established by the Hearing Officers, on November 21, 2001, The Berkshire Gas Company ("Berkshire" or the "Company") submitted its Initial Brief in support of its Price Cap Mechanism ("PCM", the "Plan" or the "PCM Plan") and its proposed rates and schedules for distribution service. The Company's Initial Brief demonstrates that the PCM Plan and such rate schedules are reasonable, appropriate, and consistent with relevant Department precedent and sound principles of public policy.

The Attorney General of the Commonwealth of Massachusetts (the "Attorney General"), the Commonwealth of Massachusetts Division of Energy Resources ("DOER") and the low-income weatherization and fuel assistance network, the Massachusetts Community Action Program Directors Association, Inc., and the Low-Income Energy Affordability Network (collectively "LEAN") filed Reply Briefs. The Company's Reply Brief shall not restate the arguments from its Initial Brief, but, rather, shall address issues raised in the Reply Briefs of other parties to this proceeding.[1] In addition, as described on numerous occasions during the evidentiary proceedings, in order to facilitate the Department's review, the Company provides herewith in Attachment A its updated cost of service schedules that reflect the updates or revisions developed during the hearings or in brief.

[1] The Attorney General assumes that the Company's election not to respond to unspecified arguments in his Initial Brief constitutes a concession or waiver. AG Rep. Br., p. 1, n. 1. There is no basis for that assumption in the Company's Initial Brief or in this Reply Brief. The Company reiterates all of the arguments made in its Initial Brief as well as those arguments set forth in the testimony and other record evidence that may not have been addressed in detail in either the Initial Brief or this Reply Brief.

II. BERKSHIRE'S TEN-YEAR PRICE CAP PROPOSAL IS CONSISTENT WITH DEPARTMENT PRECEDENT AND PROVIDES SUBSTANTIAL BENEFITS FOR CUSTOMERS.

A. Introduction

As detailed in the Company's Initial Brief, in this case Berkshire is proposing to implement a ten-year PCM Plan that has been carefully developed with the expert assistance of Dr. Kenneth Gordon and National Economic Research Associates, Inc. ("NERA"). Berkshire's PCM proposal provides a performance-based approach to rates that caps prices for Berkshire's customers for a decade and requires the Company to satisfy rigorous service quality standards. The Attorney General, the DOER and LEAN have each addressed certain aspects of the Company's PCM presentation in this case in their Reply Briefs. The Company will address certain of these arguments below.

At the outset, the Company notes that LEAN commends it, writing that "Berkshire has been a leader in helping its low-income customers, with both a discount rate and the Commonwealth's longest running low-income utility efficiency program." LEAN Rep. Br., p. 1. While LEAN advocates a modification in the Company's gas purchasing practices (which modification is strenuously opposed by the Attorney General), LEAN elected not to recommend changes to the PCM.[2] The Company does not want to mischaracterize or overstate LEAN's position, as LEAN has not affirmatively supported the PCM. The Company, however, wishes to acknowledge its appreciation of LEAN's compliments with respect to its diligent efforts at serving its valued low-income customers. Berkshire is pleased that the PCM will provide particular benefits to Berkshire's low-income customers in terms of ensuring rate stability

[2] On December 4, 2001, the Department opened a generic docket, Risk Management Techniques to Mitigate Natural Gas Price Volatility, D.T.E. 01-100, that will address the statewide concerns raised by LEAN in its briefs in this case.

(through price caps, annual rate design and discounted rates) and the maintenance of high quality service (through strict service quality protections). The Company looks forward to continuing its strong working relation with LEAN as the PCM takes effect.

B. The Company's Service Quality Plan Complies With the Department's Rigorous Guidelines Adopted in D.T.E. 99-84

As part of its PCM Plan, the Company proposes to implement, without deviation, the demanding service quality standards (the "Guidelines") adopted by the Department in Service Quality Standards, D.T.E. 99-84 (June 29, 2001) ("D.T.E. 99-84"); see also Service Quality Standards, Order on Motion for Clarification, D.T.E. 99-84-B (September 28, 2001). As detailed in Section II.B.9 (pp. 35-39) of its Initial Brief, Berkshire has totally embraced the service quality standards adopted by the Department. Exh. BG-22, p. 9. The detailed terms of the Company's service quality plan are provided in Exhibit DOER 1-4. The DOER and the Attorney General take somewhat differing approaches to the Company's service quality proposal. While the DOER still attempts to challenge the Company's filing on procedural grounds and seeks to somehow argue that the Company has not yet filed a service quality plan, the Attorney General clearly acknowledges that the Company has, in fact, filed such a plan, although he takes issue with certain terms and proposes several changes to the Company's proposal. Compare DOER Rep. Br. at 3 with AG Rep. Br., p. 10. The Company addresses these various arguments and concerns below.

In its Reply Brief, the DOER again elects to ignore the substance of the Company's filing and continues to rehash the procedural issues initially raised prior to the commencement of evidentiary hearings, in the Attorney General's October 1, 2001 Motion to Dismiss. In its Initial Brief, the Company primarily referred the Department to its response to said Motion to Dismiss, which the Company filed on October 9, 2001 ("Response"). The Company elected this simplified approach because all of the DOER's concerns were conclusively addressed in the Response. The DOER, however, seems unwilling to part with these procedural issues, notwithstanding that 17 productive days of hearings occurred after the Motion was filed, during which the Company's service quality plan was robustly reviewed.

Moreover, in its Reply Brief, the DOER seeks to argue that "the Company's silence regarding these issues strongly suggests that the Company. . . agrees with DOER's conclusion." DOER Rep. Br., p. 5, n. 4. This is – as the DOER obviously knows – patently false. The fact that the Company has affirmatively elected not to rehash old procedural matters given the existence of its comprehensive Response simply reflects its judgment that this matter is squarely before the Department and that the Company's position is plainly correct. Indeed, there is absolutely no doubt whatsoever that the record clearly establishes: 1) that the Company has agreed, from the very outset of this case in its July 17, 2001 filing, to the generic standards required by the Department in D.T.E. 99-84; 2) that implementation of the D.T.E. 99-84 standards is an integral part of the PCM; and 3) that the Company proposes no deviations from the D.T.E. 99-84 standards. See Co. In. Br., pp. 35-39. In essence, the DOER seeks to focus exclusively on format and process, as opposed to the undisputed substance of the Company's proposal.

In making arguments with respect to service quality issues, both the DOER and the Attorney General resort to the old litigation tactic of setting up a "straw man" to knock down. In particular, the Attorney General and the DOER seek to argue that the Company's service quality material was somehow only "supplied involuntarily, in response to an information request" (DOER Rep. Br., p. 6, n. 7) and that the "Company generated an SQI Plan only in response to dogged discovery by the DOER" (AG Rep. Br., p. 13). These claims expose the hollowness of the DOER's and the Attorney General's arguments. In its initial filing, the Company explicitly stated that it would supplement its PCM Plan to provide supporting information with respect to the details of its service quality plan based upon the then very recently issued order in D.T.E. 99-84. See Exh. BG-23, Exhibit KLZ-1 ("Term Sheet") at 3; Exh. BG-1, p. 22; Exh. BG-22, p. 15. In its first round of discovery, the DOER asked for these materials that the Company had already indicated it would be providing. The Company provided this information in Exhibit DOER 1-4, and, thereafter, in a supplemental response to the same information request. In short, the DOER merely asked for information that the Company had already said it would provide and other parties now seek to argue that this information was somehow provided involuntarily and only after "dogged" discovery. The facts indicate that nothing could be further from the truth. This is a theme that repeats itself in the Reply Briefs of both the DOER and the Attorney General; the facts of the Company's proposals are often at odds with the bold pronouncements and arguments made by the Attorney General and the DOER.

Footnote 4 (p. 5) of the DOER's Reply Brief helps illustrate the baselessness of the DOER's arguments, and the fallacy of its excessive focus on verb tense. In this footnote, the DOER castigates the Company, noting that "the Company's stated future intent *to comply with the [D.T.E. 99-84] reporting. . . requirements is not compliance*." Id. (emphasis in original). In short, the DOER attempts to argue that the Company's service quality plan is deficient because the Company has not yet filed the periodic service quality reports required in the future by the D.T.E. 99-84 Guidelines. The DOER ignores the fact that no such reports are even due yet under the Guidelines and tries to turn the Company's agreement to provide such reports when due into a negative. The Company simply does not know what the DOER expects it to have done differently.

Outside of baseless procedural arguments, the Attorney General and the DOER do raise two substantive issues with respect to service quality matters in their Reply Briefs. The first issue concerns the Attorney General's arguments regarding the three measures for which the Company does not yet have valid data for three full years: 1) telephone service factor; 2) service appointments met; and 3) on-cycle meter readings. See Co. In. Br., p. 36. By way of background, as noted in Exhibit DOER 1-4 and in its Initial Brief, the Company is proposing to establish benchmarks for each of these measures as soon as three full years of valid data are available. This is in accordance with the Company's understanding of the Department's directives in D.T.E. 99-84, which expressly provide that benchmarks for such measures shall not be established until three full years of data are available.[3] As with other utilities in Massachusetts, the fact that the Company does not have three full years of data for each service quality measure ultimately adopted in D.T.E. 99-84 in no way indicates a failure to comply with that Order. Indeed, the Department contemplated that this would be the case in issuing its Order in D.T.E. 99-84:

> [T]he Department recognizes that no SQ plan in accordance with the guidelines established by this proceeding shall be effective immediately. To facilitate a speedy transition to these guidelines, however, the Department directs each electric and local gas distribution company to begin collecting, as of the date of

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[3] The D.T.E. 99-84 Guidelines expressly provide that:

> [T]he historical average and standard deviation for benchmarking will be based on the most recent years worth of data for each company. This will be a fixed average for duration of the PBR. Where ten years worth of information is not available to a specific company, the company is directed to use the maximum number of years of data available, **so long as three years are available**. As the company collects additional data, that data will be included in benchmarking until ten years worth of data is collected.

Guidelines at §I.C. (emphasis added).

> this Order, all the data necessary to implement a SQ plan based on these guidelines.

Id. at 42-43. The Company submits that the fact that it already has service quality data for the majority of measures adopted in the Order demonstrates its diligence.

The Department can readily dismiss the Attorney General's recommendation that the Company should pay the "maximum penalty" attributed to these three measures (AG Rep. Br., pp. 9-10) until it has three full years of data because the Department's Order in D.T.E. 99-84 contains no provisions for such penalties and, indeed, expressly contemplates that utilities may not have data for all of the categories at this time. See n. 3, supra. If the Department had wanted to establish penalties for these benchmarks it clearly would have done so in the Guidelines, especially given that, in its Order in D.T.E. 99-84, the Department expressly recognized that data for three years might not be available for some benchmarks. The fact that the Department did not adopt such an automatic penalty conclusively disproves the Attorney General's complaint. See, e.g., Livoli v. Zoning Board of Appeals of Southborough, 42 Mass. App. 921, 923 (1997) (citing the "canon of construction, namely, inclusio unius est exclusio alterius" in finding that the zoning board appropriately did not "read into" a zoning by-law a dimensional requirement that was conspicuously omitted from the language of the by-laws).[4] The Company would also

[4] See also Protective Life Insurance Company v. Sullivan, 425 Mass. 615, 620 (1997) (note reference omitted), where the Supreme Judicial Court held:

> We have said that "the fact that the Legislature specified one exception . . . strengthens the inference that no other exception was intended." LaBranche v. A.J. Lane & Co., 404 Mass. 725, 729, 537 N.E. 2d 119 (1989). See Bagley v. Illyrian Gardens, Inc., 401 Mass. 822, 824, 519 N.E. 2d 1308 (1988) ("Expressio unius est exclusio alterius"); Collatos v. Boston Retirement Bd., 396 Mass. 684, 687, 488 N.E. 2d 401 (1986) ("it is appropriate to follow the maxim that the statutory expression of one thing is an implied exclusion of other things omitted from the statute"); Harborview Residents' Comm., Inc. v. Quincy Hous. Auth., 368 Mass. 425, 432, 332 N.E. 2d 891 (1975), and cases cited. See also 2A C. Sands, Sutherland Statutory Construction § 47.23, at 217 (5th ed. 1992).

emphasize the Department's finding in D.T.E. 99-84:

> It is worth noting that the purpose of SQ penalties is not to maximize the level of penalties collected, but to provide an impetus for gas and electric distribution companies to conduct themselves in such a way that there is no need to impose monetary penalties in the first place. See August 17th Order at 49 n. 37. This purpose has parallels in monetary fines provided for in many criminal and civil statutes.

Id. at 29, n. 27.

The DOER raises a second, somewhat related issue, recommending that, until data is established for the three measures in question, the Company should pro-rate the percentage penalties for those measures for which it does have data in order to ensure that the maximum potential 2% penalty applies. DOER Rep. Br., p. 8. The DOER's suggestion similarly is not supported by the Department's Order in D.T.E. 99-84, which expressly provided – after extensive hearings – for specific penalty levels for defined service measures. See D.T.E. 99-84, pp. 32-33. The DOER's proposal would serve to increase the penalties related to specific measures beyond the levels expressly established in the Department's carefully articulated Order. Again, it is essential to emphasize that in its Order in D.T.E. 99-84, the Department recognized that when new service quality measures were implemented it was likely that utilities would not have data for three years for all such measures. Id. at 42-43. If the Department had intended to adopt the DOER's proration approach during the interim period in which data was being collected for a measure, it would have done so explicitly. See Livoli v. Zoning Board of Appeals of Southborough, 42 Mass. App. 921, 923 (1997); Protective Life Insurance Co. v. Sullivan, 425 Mass. 615, 620 (1997); see also n. 4, supra. The Guidelines, however, provide for no such proration, and the DOER should not seek to have the Department rewrite such Guidelines on a company-specific basis without any record support. Indeed, the Company submits that one of the strengths of the Guidelines is that they are meant to be applied generically.[5] Also, Berkshire emphasizes that the term of the Plan is ten years, and during the vast majority of such term, because of the Company's ongoing data collection, service quality benchmarks and related penalties will be in place for **all** of the D.T.E. 99-84 measures. (See Exh. DOER 3-1(a) and Exh. DOER 1-4, indicating that benchmarks for the three remaining measures will be effective on January 1, 2003, January 1, 2004 and January 1, 2005, respectively; see also Co. In. Br., p. 37.)

In sum, there is not a scintilla of evidence in the record that the Company is proposing to do anything other than implement the exact service quality requirements adopted by the Department in the Guidelines. The Company has put forward a well-balanced and compliant service quality proposal and all interested parties have had ample opportunity to review such proposal and the underlying data for each of the Company's specific service quality benchmarks. Accordingly, the Department should reject the DOER's and the Attorney General's arguments and approve the Company's service quality proposal.

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[5] This intent was clearly articulated in the Department's letter decision dated December 5, 2001 with respect to D.T.E. 99-84 Compliance Filing of Massachusetts Electric Company and Nantucket Electric Company.

> Furthermore, concerns of consistency in this proceeding may militate against approval of an offer of settlement that diverges from the Guidelines. The Department opened this matter in October 29, 1999. We solicited numerous rounds of comments and issued an interim order with proposed guidelines on August 17, 2000. D.T.E. 99-84 (Interim Order) at Att. A. We received several more rounds of comments before issuing our Order containing the final Guidelines on June 29, 2001 and subsequently, an Order on Motion for Clarification on September 28, 2001. Throughout this lengthy participatory process, our goal was explicit: to develop guidelines or standards to be applied to all utilities. The rationale for developing uniform guidelines rather than company-specific plans was simple. It promotes administrative efficiency and allows the Department to evaluate each company's performance in comparison with other utilities.

Id. at 4.

C. <u>The Company's Enhanced Productivity Factor is Well Supported</u>

In his Reply Brief, the Attorney General complains that the Company's enhanced productivity factor is not supported because the Company, after consulting with Dr. Gordon and NERA, elected not to perform a costly new productivity study. AG Rep. Br., pp. 11-14. The Department can readily reject the Attorney General's arguments. The Attorney General's position (including his argument that the Company is not reasonably comparable to Boston Gas in terms of productivity) flatly ignores the Department's very specific findings in <u>Eastern Enterprises/Colonial Gas Company</u>, D.P.U. 98-128 (1999), that:

> [B]ecause productivity offsets are **not Company-specific**, it is appropriate to use a productivity offset developed for another LDC for the purpose of this case. Therefore, the Department finds it is reasonable to use the same productivity offset implemented for Boston Gas.

<u>Id</u>. at 63-65 (emphasis added). Given that productivity offsets are not company-specific, it simply would not make sense for a company of Berkshire's size to undertake a very costly new study of limited probative weight. <u>See</u> <u>Boston Gas Company</u>, D.P.U. 94-14 (1999) (utilities must strike balance between accuracy and costs with respect to decisions to undertake quantitative studies).

Further, the Attorney General argues that a new productivity study may not be as expensive as Dr. Gordon suggested. The Company would submit that, whether the cost of the study was $150,000 or as high as $500,000 (as Dr. Gordon indicated), such expense is material and is not necessary. Exh. DTE 2-4; Tr. 1, p. 47. Further, the Attorney General has introduced absolutely no evidence indicating that Dr. Gordon's estimates are not reasonable.

Relatedly, there is not any evidence whatsoever that has been brought forth in this case that supports the adoption of any productivity factor other than that submitted by the Company. Indeed, neither the DOER nor the Attorney General has sponsored any witnesses to address these matters. In contrast, as illustrated by the Company's expert testimony and as summarized in its Initial Brief, through Berkshire's enhanced productivity offset, the Company will return to customers an annual enhanced productivity dividend through a 1% annual base rate decrease, regardless of whether the Company's management has actually been able to reduce costs. Term Sheet at 2; Co. In. Br., pp. 20-25. (Such decrease is applied as an offset to the inflation factor so that in the event inflation is greater than 1%, any annual rate increase would be 1% lower than it otherwise would have been, and in the event inflation is less than 1%, base rates would **decrease** in both nominal and real terms.) Id. Very significantly, this 1% enhanced productivity offset is directly consistent with the overall 1% offset currently adopted for Boston Gas Company in Boston Gas Company, D.T.E. 96-50 (1996) ("Boston Gas, D.P.U. 96-50" or "D.P.U. 96-50") after the Department's reconsideration orders.[6] See Co. In. Br., pp. 24-25.

The Attorney General also argues that the Department should reject Dr. Gordon's recommendations supporting the Company's proposed productivity offset on the ground that "Mr. Gordon is not qualified as an expert by doing one productivity study here or at any other time." AG Rep. Br., pp. 12-13. The Company is fully comfortable letting Dr. Gordon's testimony and qualifications speak for themselves. The Company respectfully submits that such testimony and qualifications are entitled to significant weight by the Department and the Company is gratified that Dr. Gordon supported not only its enhanced productivity factor, but its PCM Plan in its entirety:

> So in summary, my view is that this is a balanced [P]lan when looked at in its entirety, the pieces fit together well, and the [P]lan should be viewed as a whole, not simply one piece at a time or as a menu from which particular items can be selected and others rejected. It is meant to be a coherent whole. It is relatively

[6] See Boston Gas Company, D.P.U. 96-50-C (Phase I) (May 16, 1997); Boston Gas Company, D.P.U. 96-50-D (January 16, 2001).

> simple, appropriate for a company the size of Berkshire Gas, and in my view deserves to be approved by the Department.

Tr. 1, p. 12.

D. The Company's Exogenous Costs Proposals are Reasonable

The Attorney General and the DOER take conflicting positions with respect to the Company's exogenous costs proposal. The Attorney General argues that the Company should not be permitted to include lost base revenue ("LBR") as an exogenous cost because Berkshire's PCM will go into effect after the Department's change in policy regarding LBR has gone into effect (i.e. after the Department's adoption of the rolling period methodology in Colonial Gas Company, D.T.E. 97-112 (1999)).[7] AG Rep. Br. at 18. In contrast, the DOER argues that the Department "will consider lost base revenues that exceed the rolling method as an exogenous cost if an exogenous cost calculation filing, with supporting documentation, is submitted for a comprehensive Department review." DOER Rep. Br. at 13. While the Company has certain significant disagreements with respect to portions of the DOER's proposal, it submits that the DOER's proposed approach is far closer to correct and that the Attorney General's approach can be summarily rejected.[8]

[7] LBR or lost margins are defined as "the non-gas-cost portion of a gas utility's base rate that is lost between rate cases as a result of reduced sales caused by the implementation of demand side management, or DSM programs." Boston Gas Company, D.P.U. 90-17/18/55, at 139 (1990). Under the rolling period methodology, "LBR associated with the specific year of DSM implementation would be recovered for a period equal to the average length of time between each of a company's last four rate cases, or until new rates take effect subsequent to a new base rate proceeding." Colonial Gas Company, D.P.U. 97-112 at 11 (1999).

[8] The Company acknowledges the helpful role of both the Attorney General and DOER in developing its demand side management ("DSM") programs through collaborative settlements. See, e.g., The Berkshire Gas Company, D.T.E. 01-29 (2001); The Berkshire Gas Company, D.P.U. 96-92 (1996). The Company looks forward to continuing its positive working relationship with these parties regarding DSM matters.

The Company would respectfully refer the Department to section II.F.1 (pp. 48-52) of its Initial Brief, where it demonstrated that its proposal with respect to limited recovery of LBR as an exogenous cost in the mid-to-later years of the Plan is squarely supported by Department precedent. In contrast, the Attorney General's argument that there should be absolutely no protection with respect to unrecovered LBR during the Company's ten-year rate plan entirely ignores both Department precedent and the facts in this case. With respect to Department precedent, in Bay State Gas Company, D.T.E. 00-106 (March 30, 2001), the Department expressly ruled, **after** its decision adopting the rolling methodology in Colonial Gas Company, D.T.E. 99-112, that on a going forward basis "Bay State, **or any other LDC** seeking to recover LBR not recouped through the application of the rolling period methodology, must submit an exogenous cost calculation with appropriate supporting documentation for the Department's review." Id. at 2 (emphasis added). In short, the Department has expressly provided that LBR should be addressed through exogenous cost filings on a going forward basis, and Berkshire's Plan comports with these directives.

Relatedly, the Department's policy is soundly supported by the facts in this case. One of the Company's main reasons for filing this case has been the implementation of the rolling period methodology and the resultant loss of $500,000 in revenues in 2001 alone. See Exh. BG-1, pp. 16-17. Historically, a utility's remedy when faced with excessive unrecovered LBR was to file a rate case. With respect to a price cap model, where that remedy is not available, it is essential that LBR matters be addressed up front. Indeed, if such matters are not addressed up front, the Company would be forced to re-examine its current strong commitment to implementing DSM programs. Tr. 3, pp. 356-58. Also, the Company emphasizes that, as Ms. Zink testified, Berkshire's proposal is not a dollar-for-dollar make whole provision, but rather is a prudent protection against foreseeable, material financial hardships in the context of a 10-year performance-based ratemaking proposal. Tr. 3, pp. 273-74, 348-49; Tr. 4, pp. 435-51. The Company would stress that given its ability to recover LBR subject to the rolling period methodology in the early years of the Plan, recovery of LBR as an exogenous cost only becomes a material issue in the mid-to-later years of the Company's plan (i.e. 2005/2006 and after). Tr. 3., pp. 273-74; 348-46.[9]

The Company would also emphasize that its proposal regarding recovery of LBR as an exogenous cost during the term of the PCM is squarely consistent with the Department's very recent Order in Colonial Gas Company, D.T.E. 00-73 (November 20, 2001) ("D.T.E. 00-73"), which Order is ignored by both the DOER and the Attorney General. In this Order, the Department allowed recovery of $717,135 of LBR as an exogenous cost adjustment for Colonial Gas Company. In D.T.E. 00-73, the Department stated that:

[9] The DOER's argument that the Company will somehow seek LBR recovery through an exogenous cost approach as early as February 1, 2002 is an absolute red herring. DOER Rep. Br. at 13-14. The DOER can make this argument only by quoting the testimony of Ms. Zink completely out of context. Ms. Zink only testified, in response to hypothetical questioning as to whether there was any possibility whatsoever that the Company could seek, in any circumstance, LBR exogenous cost recovery in 2002. In contrast to the out of context quotation referred to by the DOER in its Reply Brief at pp. 13-14, Ms. Zink's testimony with respect to this matter needs to be read in its entirety. See Tr. 4, pp. 435-51. Ms. Zink's testimony makes clear that "if the Department does not change its existing policy on DSM programs or its policy on recovery through the rolling period methodology," the earliest the Company would seek an exogenous cost calculation would be 2005 or 2006. Tr. 4, pp. 437-38; Tr. 3, pp. 273-74. Ms. Zink merely went on to testify in response to cross examination that conceptually, and **only if** the Department were to change its current policy, the Company conceivably could seek recovery of LBR as an exogenous cost earlier than that date. The DOER then goes on in its Reply Brief to complain that the Company did not reiterate this position in response to a record request. See DOER Rep. Br., p. 14. The Company would respectfully note that no such record request was made by the DOER. Again, the Company's position is uncontroverted that, assuming no changes to the Department's current policy, which would allow Berkshire to recover LBR associated with DSM measures over a rolling period of four years, LBR as an exogenous cost will not even become an issue until 2005/2006, at the earliest.

> The proponents of an exogenous cost adjustment bear the burden of demonstrating: 1) that the cost change is of a type external to the Company and is beyond the Company's control; 2) that the magnitude of the cost change is such so as to significantly affect the Company's operations; and 3) that the Company's earnings, independent of recovering a proposed exogenous cost, are reasonable.

Id. at 22.

The Company stands ready to abide by these standards with respect to its recovery of LBR as an exogenous cost. Its proposal in the PCM Plan is entirely consistent with such standards, given: 1) that unrecovered LBR clearly represents a cost change resulting from a "directed investment" external to the Company i.e., the Department's mandate that utilities implement sales-reducing DSM measures (See Exh. BG-3, p. 25); 2) that the Company has proposed a $50,000 threshold before it can recover any uncollected LBR, clearly satisfying the Department's materiality requirement (see infra; and 3) that the Company is willing to demonstrate in any exogenous cost filing that its earnings would not be reasonable absent recovery of LBR. Importantly, in D.T.E. 00-73, the Department rejected the Attorney General's argument "that recovery of LBR as an exogenous cost in this proceeding would lead to double-collection by the Company." Id. at 25. Similarly, in this case, recovery of LBR as an exogenous cost would present no double-collection issues because any such LBR to be recovered in the future (e.g. in 2005/2006 or later) would not be recovered in the base rates being established in this proceeding, which are based on 2000 test year sales. Following this case, in which new base rates reflecting savings from all pre-test year DSM installations are being established, the Company will only be eligible for LBR recovery for savings resulting from measures installed in the test year and thereafter.[10] Accordingly, the Company respectfully requests that the

[10] The Company is only eligible to recover LBR for a portion of savings resulting from DSM installations during the test year. See Cambridge Electric Light Company/Commonwealth Electric Company, D.T.E. 93-15/16 (June 30, 1993).

Department accept its reasonable, balanced proposal with respect to addressing LBR as an exogenous cost during the ten-year term of the PCM Plan.

Finally, counter to the DOER's position (see DOER Rep. Br., pp. 10-11), the Company has maintained proportionality in its exogenous cost proposal. Its $50,000 threshold is squarely between the costs found reasonable for Boston Gas (D.T.E. 96-50) and Colonial Gas (D.T.E. 98-128). It also is proportional to the thresholds for other companies considered by NERA. See Exh. DOER 1-8. Moreover, there is absolutely no record support for the DOER's proposed threshold of $75,000. Indeed, such a threshold level is patently **disproportional** even when compared to the highest comparable company (Colonial). Id. Relatedly, while Berkshire is aware that the Department has not supported cumulative exogenous cost proposals for Boston Gas, the Company's cumulative exogenous cost proposal is justified given that it is proposing a ten-year rate plan, much longer than the five-year rate plan approved for Boston Gas in D.P.U. 96-50 (in which the Department did not approve cumulative thresholds). The Company's proposal merely allows it to protect against material adverse consequences beyond its control in the context of a long-term "stay out" period. Importantly, the threshold is only triggered when the aggregate amount of $50,000 in costs is reached, thereby ensuring that proceedings are not held for minimal dollars. See Colonial Gas, D.T.E. 98-128 at 55 (1999).[11]

E. The Company's Rebuttal of Miscellaneous Attorney General PCM Arguments

1. The PCM Will Result in Just and Reasonable Rates

Counter to the arguments set forth at pages 15-16 of the Attorney General's Reply Brief regarding alleged "unauthorized PCM protections," the Company's PCM is squarely based upon

[11] Importantly, adjustments are made, in **both** directions.

a test year approach (see, e.g., Exh. BG-5, p. 3) and does not seek to replace a "just and reasonable standard" for rate review with a "no net harm" standard. The Company's arguments with respect to "no net harm," as articulated in the Company's Initial Brief, **only** apply to the extent its stand alone cast off rate proposal is deemed to have G.L. c. 164, §96 implications. Co. In. Br., pp. 44-48. Indeed, the Department has dispositively addressed these issues in Boston Edison Company, et al., D.T.E. 99-19 (July 27, 1999), where it expressly found that: "In making a determination pursuant to G.L. c. 164, §94 whether the rates that would result from [a] rate plan are just and reasonable and in the public interest, the Department's judgment is informed by the G.L. c. 164, §96 public interest standard." Id. at 8. The Department went on to state that the §96 public interest standard "must be understood as a 'no net harm,' rather than a 'net benefit' test." Id. at 10-11. In short, the Company's proposal directly complies with this Department precedent and ensures that rates under its PCM, which clearly satisfy the "no net harm" test, will be just and reasonable. See also Section II. F., infra.

The Attorney General suggests, in a one-sentence assertion unadorned by argument, that the mid-period review somehow runs afoul of G.L.c. 30A, §1(6) because it substitutes a "clearly" or "clearly and substantially" standard for the "preponderance" standard imposed by statute. The Attorney General is confused on two scores. First, §1(6) simply provides a definition of the term "substantial evidence," which, in turn, is the standard by which appeals from agency adjudicatory proceedings are measured, not the standard employed for purposes of the adjudicatory proceedings themselves. See, e.g., G.L.c. 30A, §14(7)(e). Second, and more fundamentally, G.L.c. 30A, §1(1) defines "adjuticatory proceeding," in part, as follows: "'Adjudicatory proceeding' means a proceeding before an agency in which the legal rights, duties or privileges of specifically named persons are required by constitutional right or by any provision of the General Laws to be determined after opportunity for an agency hearing." The mid-period review, of course, is a creature neither of the constitution nor of the General Laws, but rather of the PCM Plan itself. The PCM Plan could just as easily have been crafted without provision for any mid-period review. To suggest, as the Attorney General does, that a protection for the Department and customers that need not exist at all – and that certainly is not required by either the constitution or any provision of the General Laws – nonetheless falls within the ambit of Chapter 30A is as illogical as it is unsupported.[12]

2. <u>Telephone System Costs</u>

The Attorney General's argument that the Company seeks to recover more than $200,000 in telephone system upgrades in this case is simply wrong. <u>See</u> AG Rep. Br., p. 11, n. 14. As testified by Ms. Zink, the Company is not proposing to roll the cost of these telephone system upgrades into rates at this time. Tr. 14, p. 1841. The Company has merely reserved the right to recover such costs through an exogenous cost filing under the PCM in order that it can ensure the provision of reliable service in compliance with the Guidelines.

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[12] As Dr. Gordon demonstrated, in order to provide the full incentives of a plan with a 10-year term, "the PCM must be expected to continue for its full term." DTE-RR-4. Berkshire explained that the standard for any early termination of the plan therefore should be high, namely these is a showing that:

> (1) customers would be clearly and substantially harmed by the continuation of the Plan; and (2) Berkshire's rates, in aggregate for the duration of the Plan, are clearly not just and reasonable.

<u>Id</u>. Thus, the standard for the mid-period review is a critical component of the well-considered, balanced PCM. Provided the Company proves the reasonableness of including its mid-period review proposal within the PCM Plan by a preponderance of evidence in this proceeding, any relevant requirements of G.L. c. 30A with respect to the terms of the PCM (that is the subject of this proceeding) will be satisfied and the Department can and should implement a heightened standard for its mid-period review.

3. <u>The Need to Consider Berkshire's Unique Service Territory</u>

In response to the Attorney General's comments that certain of the Company's rates are higher than those of some other LDCs in Massachusetts (AG Rep. Br., pp. 2-3, 13), the Company wishes to raise several points.[13] First, all of the Company's rates and charges currently charged to customers have been reviewed and approved by the Department and deemed just and reasonable after such review. In other words, the costs underlying every penny on Berkshire's customers' bills have been scrutinized and found to be reasonable by the Department, whether in base rate proceedings, conservation charge adjustments, residential conservation service ("RCS") surcharge proceedings, or periodic cost of gas and local distribution charge adjustments. Second, in the context of the statewide RCS program, the Department has performed an extensive comparison of the costs of delivering certain services among LDCs in Massachusetts. In these proceedings, Berkshire demonstrated that it served significantly fewer customers than other comparable LDCs and that its fixed costs of delivery services are spread over a substantially smaller base of customers than those of other providers in the comparison group. The Company also demonstrated several other factors as to why its costs for certain services might be somewhat higher than those of other LDCs. In particular, Berkshire's service territory is unique, being mainly rural, thinly populated, and serving towns spread out over a very wide geographic area. In addition, the ratio of single to multi-family housing in the Company's service territory is

[13] As a general matter, the Department should consider the procedural context of the Attorney General's arguments. First, the Attorney General can only present such evidence based upon the "lawyer testimony" he criticizes elsewhere. There is absolutely no record citation for any of the Attorney General's arguments regarding relative charges. Second, and more troubling, is the fact that the only potential basis for the Attorney General's arguments is a tainted, error-filled document that the Hearing Officer found to be so unreliable that he took the extraordinary step of striking such document at a point when it had only been marked. Tr. 1, p. 58. Thus, the Attorney General's arguments are made in blatant disregard of the Hearing Officer's sound evidentiary ruling.

higher than that of other companies, which can serve to increase the Company's fixed costs. See generally The Berkshire Gas Company, D.P.U. 95-48 (1995), The Berkshire Gas Company, D.P.U. 96-52 (1996), The Berkshire Gas Company, D.P.U. 97-56 (1997), and The Berkshire Gas Company, D.T.E. 98-44 (1998).[14] The Department considered all these factors and approved the Company's RCS submissions in each of these cases. In addition, the Department has approved all of the Company's resources and its resource planning process in contract reviews and recent forecast and supply plan proceedings. See, e.g., The Berkshire Gas Company, D.T.E. 98-99 (1999). As demonstrated in this case, the Company has worked diligently to control costs, and all the rates proposed by Berkshire are supported by detailed cost of service analyses. Especially when the demographics of Berkshire's service territory are considered, it is clear that Berkshire continues to provide least cost, reliable service to its customers.

F. The Company's PCM Proposal Properly Addresses all Merger-Related Issues in a Manner Highly Beneficial to Customers, and the Department Can Readily Reject the Attorney General's Recycled Arguments in this Case

In his Reply Brief, the Attorney General once again raises his objections to the Department's progressive, customer-focused merger-related policies. In many respects, the Attorney General's arguments on pp. 3-12 of his Reply Brief are a rehash of the arguments raised by the Attorney General in earlier cases involving mergers at the Department and in the Attorney General's ongoing appeals of the Department's decisions in those cases, complete with continuing citations by the Attorney General to hoary and inapplicable cases such as Smyth v.

[14] If necessary, the Company would, as an example, refer the Department to Exhibit 11 in the Company's original filings in D.T.E. 98-44 case for further information comparing Berkshire's costs with those of other LDCs.

Ames, 169 U.S. 466 (**1898**) (emphasis added).[15]

The Company respectfully refers the Department to Sections II.B. 1, II.E. and II.F.2 of its Initial Brief (pp. 14-6; 44-8; and 52-3), in which it addresses merger-related issues in detail, and the Company hereby incorporates by reference the arguments set forth therein. By way of summary, under the terms of its PCM, Berkshire is **not** seeking to add any merger-related costs to base rates under the Plan, and all such costs have been stripped out of its rates. In return, Berkshire seeks the opportunity (but not the guarantee) of offsetting these costs through the retention of savings generated during the term of the PCM.[16] See generally Exh. BG-1, pp. 21-23; Exh. BG-3, pp. 12-14. Cf. Eastern/Colonial Gas, D.T.E. 99-128 (Approving cast off rates for

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[15] Indeed, of the court cases cited in support of the Attorney General's legal arguments, the years of decision are as follows: 1944, 1898, 1923 (citing Justice Brandeis' dissent), 1968, 1944, 1942, 1923, 1950, 1956 and 1943. See AG Rep. Br., pp. 6-9. Apparently, the Attorney General prefers to ignore the major developments in utility regulation and jurisprudence over the past 30 years. See, e.g., n. 23, infra. Suffice it to say that the United States Supreme Court has dispositively rejected arguments (of the type apparently advanced by the Attorney General) that any single theory of ratemaking or valuation must be applied by utility commissions, and has given commissions such as the Department wide latitude in adopting appropriate policies. See, e.g., Duquesne Light Co. v. Barash, 488 U.S. 299, 316 (1989), where the Court held:

> The adoption of a single theory of valuation as a constitutional requirement would be inconsistent with the view of the Constitution this Court has taken since Hope Natural Gas, supra. As demonstrated in Wisconsin v. FPC, circumstances may favor the use of one ratemaking procedure over another. The designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both customers and investors. The Constitution within broad limits leaves the States free to decide what ratesetting methodology best meets their needs in balancing the interests of the utility and the public.

The Department's merger-related policies clearly fall within these broad limits established by the Court. Indeed, Berkshire's PCM strikes a highly appropriate balance between the interests of customers and the Company.

[16] As set forth in Exh. AG 10-12, the Company has booked $66,263,858 in merger-related goodwill allocated to the Company, including a portion of the acquisition premium for Berkshire Energy Resources and related transaction costs.

Colonial to reflect a forecasted increase to its stand alone base rates for purposes of calculating merger-related benefits). The Department has consistently accorded companies the opportunity to recover merger-related costs so long as such recovery does not result in "net harm" to customers, and Berkshire has the right to reasoned consistency in the treatment of its PCM proposal as compared with the Department's treatment of other merger-related rate plans. See, e.g., Boston Edison, D.T.E. 99-19; Eastern/Colonial Gas, D.T.E. 98-128; Northern Indiana Public Service Company/Bay State Gas Company, D.T.E. 98-31 (1998) ("NIPSCO/Bay State Gas, D.T.E. 98-31"); Eastern Enterprises/Essex County Gas Company, D.T.E. 98-27 (1998) ("Eastern/Essex, D.T.E. 98-27"); New England Electric System/Eastern Utilities Associates, D.T.E. 99-47 (2000) ("NEES/EUA, D.T.E. 99-47"); see also Boston Gas Company v. Department of Public Utilities, 367 Mass. 92, 104-105 (1975); In. Br., pp. 44-45. Berkshire again emphasizes that even though it need not seek merger approval in this case, its PCM proposal is consistent with the Department's "no net harm" merger standard because not only are Berkshire's customers not harmed by its proposal, which uses pre-merger cast off rates without inclusion of **any** merger costs, they are affirmatively benefited by an initial rate freeze, a ten-year price cap, a guaranteed consumer dividend, and the adoption of the D.T.E. 99-84 service quality standards. See Initial Brief at p. 48.[17]

In light of some of the unsupported claims in the Attorney General's Reply Brief, the Company is obliged, however, to set the record straight and rebut the Attorney General's gross mischaracterizations of its progressive PCM Plan and the Attorney General's related, unsupported conclusory statements. As an initial matter, the Attorney General's argument that

[17] Like other mergers in Massachusetts (e.g. KeySpan/Eastern Enterprises), Berkshire's merger was undertaken at the holding company level and no formal Department approval of the merger was necessary under G.L. c. 164, §96.

the reason the Company is seeking rate relief in this proceeding is "to offset the $66 million in costs and acquisition premium associated with the acquisition of Berkshire's parent company" is simply wrong and distorts the facts. AG Rep. Br. at 2. As conclusively demonstrated in this proceeding, Berkshire has an immediate need for rate relief because its earnings are extremely low given that, among other factors, it has: 1) refrained from filing a rate case for nearly nine years; 2) constructed substantial new plant including a state-of-the-art new LNG facility; 3) prudently increased wages for its valued employees (while lowering total non-union payroll); and 4) lost $500,000 in 2001 as a result of the implementation of the rolling period methodology. Exh. BG-1, pp. 9-19. While Berkshire is also using this case as an opportunity to propose a performance-based rate approach with respect to the Energy East merger in accordance with Department precedent, the Attorney General's argument that this case is somehow solely or primarily undertaken to address merger-related issues entirely ignores the facts.

The Attorney General then seeks to argue that the Company's proposal does not comport with "other merger plans approved by the Department." AG Rep. Br., p. 3. The Company readily agrees that its PCM Plan is not an exact copy of other plans approved by the Department, although all of its elements are squarely consistent with extensive Department precedent. <u>See</u> Co. In. Br., pp. 11-40 (showing how each element of the PCM complies with precedent). In this regard, it is important to emphasize that the Department has affirmatively stated that "all acquisitions will have unique characteristics, and the Department has committed to a case-by-case review, tailored to circumstances presented." <u>Eastern/Colonial Acquisition</u>, D.T.E. 98-128, p. 65; <u>Mergers and Acquisitions</u>, D.P.U. 93-167-A, p. 7. Moreover, the Department has recently directed companies to submit PBR filings with respect to mergers and undertake some risk that "incentive regulation will provide sufficient revenues to offset the acquisition premium and transactions costs." Fall River Gas Company, D.T.E. 00-25, pp. 11-14. The Company has embraced the Department's directives and Berkshire welcomes any comparison by the Department of its PCM proposal to the rate plans of other companies in connection with their mergers. Any such review demonstrates the substantial benefits for customers offered by Berkshire's Plan. In this regard, the Company wishes to highlight certain matters.

- Nearly all of the other utilities in the Commonwealth who have undertaken mergers have proposed amortization of the acquisition premium over a 40-year period and the full recovery of that premium after a limited initial base rate freeze period ranging from 4 to 10 years.[18] Not Berkshire. Provided that the Department approves the material aspects of its PCM Plan, Berkshire, unlike many other Massachusetts utilities, does not propose to subject its customers to decades of rates reflecting the amortization of millions of dollars of goodwill after the end of the term of the PCM. The Attorney General entirely ignores this core, fundamental benefit of Berkshire's Plan.

- Other utilities in the Commonwealth have presented costly reviews of speculative merger benefits and savings that have required extensive and detailed hearings.[19] Not Berkshire. In this case, Berkshire utilized a streamlined, performance-based method of addressing merger-related issues, whereby a detailed review of hypothetical benefits is not necessary given that all merger-related costs have been stripped out of rates. While this base rate proceeding did require substantial evidentiary hearings due to normal cost of service and rate design review, such hearings would have been extensively expanded (as would related regulatory costs) had the Company adopted an approach relying on expensive investment banker testimony regarding the acquisition premium and consultant/accountant testimony regarding speculative merger-enabled savings.

- Other utilities that have sought merger approval have not necessarily adopted incentive regulation and/or filed PBR plans.[20] Not Berkshire. Consistent with Department precedent in its recent Fall River (D.T.E. 00-25) and North Attleboro (D.T.E. 00-26) merger Orders, Berkshire proposes to address merger-related issues through the performance and incentive ratemaking approaches developed in its PCM.

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[18] See, e.g., Boston Edison et al., D.T.E. 99-19 (includes Cambridge Electric Light Company, Commonwealth Gas Company and Commonwealth Electric Company); Eastern/Colonial Gas, D.T.E. 98-128; NIPSCO/Bay State Gas, D.T.E. 98-31.

[19] See, e.g., Boston Edison et al., D.T.E. 99-19; Eastern Colonial Gas, D.T.E. 98-128.

[20] Indeed, of Massachusetts LDCs, only Boston Gas Company currently offers a performance-based price cap proposal. Boston Gas, D.P.U. 96-50.

- ?? The other gas distribution utility with a price cap plan (Boston Gas Company) has an earnings sharing mechanism providing downside risk protection to the Company.[21] Not Berkshire. Berkshire's second generation PCM eliminates the need for earnings/risk sharing and requires the Company to assume a greater downside risk in the event its return is not within a pre-set bandwidth. Customers are further ensured that rates will be just and reasonable by Berkshire's innovative mid-period review proposal. See Co. In. Br. at pp. 28-33.

- ?? Certain utilities adopting rate plans have adopted four-year or five-year rate freezes whereafter they are free to file for base rate increases.[22] Not Berkshire. In this proceeding, Berkshire is proposing to refrain from a base rate proceeding for a decade, including offering a 31-month rate freeze at the beginning of such price cap. Moreover, commencing September 1, 2004, Berkshire is proposing to offer a guaranteed 1% annual consumer dividend. In years in which inflation is less than 1% (and assuming no exogenous cost recovery), this means that Berkshire could be offering its customers rate **decreases** in certain years of its PCM.

- ?? Other gas companies quantifying merger-related savings in terms of justifying the recovery of merger-related costs have reflected gas cost savings and then indirectly rolled the value of such benefit into base rates.[23] Not Berkshire. As Ms. Zink testified, provided that the PCM as proposed is approved, the Company proposes to flow back all merger-enabled gas cost savings to customers. Tr. 8, p. 971.[24]

As these highlights indicate, from a customer standpoint, Berkshire's PCM compares extremely favorably to the plans found reasonable by the Department for other companies. While the Attorney General suggests that the Department blindly impose the plan adopted for Essex County Gas Company, D.T.E. 98-27, the Company would emphasize that, since that initial decision, there have been at least six Massachusetts cases addressing utility mergers and **none** of

[21] See Boston Gas, D.P.U. 96-50 at 324-26.
[22] See, e.g., Boston Edison et al, D.T.E. 99-19 (four-year rate freeze); NIPSCO/Bay State Gas, D.T.E. 98-31 (five-year rate freeze).
[23] See, e.g., Boston Edison et al, D.T.E. 99-19; Eastern Colonial Gas, D.T.E. 98-128. The Company emphasizes that it does not criticize other companies for this very reasonable approach – again, all mergers have unique characteristics.
[24] As described in the Company's Initial Brief, the application of fair cast-off rates and the generation of merger-enabled benefits are the only means for the recovery of merger-related cost in the PCM Proposal. Co. In. Br., pp. 44-48.

them have adopted the Essex approach.[25] As the Department has repeatedly emphasized, each Company has unique circumstances and any rate plans addressing merger-related issues must be tailored to those unique circumstances. Eastern/Colonial Gas, D.T.E. 98-128, p. 65. While Berkshire's Plan does contain several elements that are similar to the Essex/Plan approved in D.T.E. 98-27 (e.g., establishing a 10-year period to capture merger-enabled savings), there are significant differences between the companies. For example, Berkshire has been able to generate significant operating efficiencies by operating for over 8 years without a rate increase, while Essex had a base rate proceeding only 1.5 years prior to its rate freeze. See Essex County Gas Co., D.P.U. 96-70 (1996). Overarchingly, under Massachusetts law, all companies are entitled to a measure of reasoned consistency with respect to these matters, and Berkshire asks no more in this case than the opportunity to be treated in a reasonably comparable manner to other utilities in the Commonwealth.

Berkshire does not contend that it possesses an "immutable property right" to the recovery of the acquisition premium, as falsely argued by the Attorney General. AG Rep. Br., p. 6. Indeed, Berkshire has only requested the **opportunity** to recover such costs through the operation of its performance-based PCM. If the Company is unable to generate merger-enabled savings to offset merger costs during the term of the PCM, the Company bears the risk – not its customers.

The Company would emphasize, however, that, notwithstanding the Attorney General's protestations to the contrary, merger-related costs absolutely can represent funds expended for

[25] New England Electric/EUA, D.T.E. 99-17; Fall River Gas/SUG, D.T.E. 00-25; North Attleboro Gas/SUG, D.T.E. 00-26; Boston Edison, et al., D.T.E. 99-19; Eastern Colonial Gas, D.T.E. 98-128; NIPSCO/Bay State Gas, D.T.E. 98-31.

the delivery of gas distribution service and the Company does have the right to recover such costs provided that the recovery of such costs does not result in "net harm" to customers, as is the case with the Company's PCM Plan. See e.g., Boston Edison, D.T.E. 99-19, pp. 10-11. In particular, in its order in Mergers and Acquisitions, D.P.U. 93-167-A (August 3, 1994), the Department affirmatively encouraged utilities "to pursue all opportunities to reduce the costs of delivering gas, **including mergers**." Id. at 5 (emphasis added). Berkshire has affirmatively followed these directives and the merger with Energy East was pursued in order to provide benefits to both customers and shareholders. Indeed, this merger has already resulted in such benefits to customers as the innovative Portfolio Optimization Agreement approved in The Berkshire Gas Company, D.T.E. 01-41 (2001), which allows Berkshire to avail itself of the gas purchasing opportunities and economies provided by the merger. Further, other benefits are expected to be achieved as a result of the merger (e.g. reduced shareholder services costs, reduced vehicle expenses, procurement savings, etc.). See Exh. AG 9-6. Under Berkshire's PCM, however, it is the Company, not the customers, that will bear the risk if these benefits are not generated.

Relatedly, the Attorney General falsely argues that "Berkshire seeks the advantage of setting a rate increase with a 'stand-alone' calculation on the unsubstantiated promise of future merger-related savings." AG Rep. Br., p. 9. While the Company fully expects to achieve merger-enabled savings, the Company has not made any promises with respect thereto in this case and, correspondingly, has assumed the risk if they do not materialize. Indeed, counter to the Attorney General's implication that stand alone cast off rates benefit only the Company, the Company's PCM proposal utilizing stand alone cast off rates provides very substantial benefits to customers. In particular, by using stand alone cast off rates, as if the Energy East merger had not occurred, the Company is able to strip out all merger-related costs from rates. Exh. BG-1, p. 20. This provides a clear and immediate benefit to customers. Moreover, the Company is taking the additional step of offering a guaranteed 1% consumer dividend as part of its PCM. Accordingly, the Company is guaranteeing a merger-enabled benefit to customers through the PCM Plan that it would not be able to offer but for the merger. Exh. BG-3, p. 24. Contrary to the Attorney General's argument, this does not represent a "tiny fraction" of the Company's proposed rate increase. Indeed, over the life of the Plan, this will equate to a benefit of in excess of $2,000,000 (assuming the payment of consumer dividend of approximately $290,000 per annum (proposed distribution revenues of $29,000,000 x 1% x 7) beginning September 1, 2004).

Notwithstanding the Attorney General's statements (<u>see</u> AG Rep. Br., p. 4, n. 3), because the Company is not proposing to roll merger costs into rates (and because this holding company level merger was not subject to G.L. c. 164, §96), it is not necessary that the Department approve the level of acquisition premium or transaction costs in this proceeding. However, to the extent that the Department deems a review of the level of the acquisition premium or transaction costs helpful, the record in this case is complete given Berkshire's salutary and comprehensive filings in this case. For example, as noted in Exhibit BG-2, Attachment B, the acquisition premium paid with respect to the Berkshire merger falls squarely within the range of the acquisition premium paid in similar transactions. <u>See</u> <u>id</u>. at p. 21, demonstrating that Berkshire's investment bankers, Tucker Anthony, determined that Berkshire's book value ratio was 2.6 compared to a high of 3.5 and a low of 2.2, with a mean of 2.6 and a median of 2.7, for comparable utility mergers and acquisitions.[26] Similarly, Energy East's transaction costs of $1,200,000 listed in Exhibit AG 10-12 (even if one were to add the Berkshire merger costs stripped out of cost of service, e.g., the Tucker Anthony fees of $1,497,900 set forth in Exhibit BG-6, Schedule JJK-16), are well within or below the range approved by the Department in other cases involving mergers.[27] See also Exh. AG 4-1, Exh. AG 4-2, and Exh. AG 4-4 for further detail on merger costs and background. For the reasons stated above, an analysis of the Company's merger-related costs is not necessary for Department approval of the PCM, but the record fully supports the reasonableness of such costs if the Department deems such a finding necessary.

In sum, the Attorney General cannot have it both ways. If he does not wish to allow the Company to place merger costs in rates, then he cannot argue that the Company should not have the opportunity to retain benefits relating to the merger. Such a result would patently amount to confiscatory ratemaking. See, e.g., Boston Edison Co. v. Department of Public Utilities, 375 Mass 1, 10 (1978). In contrast, the Company has presented a carefully balanced, performance-based approach, providing the Department with a streamlined, customer-focused Plan in which Berkshire is using a pre-merger, 2000 test year for cast off rates and stripping out all merger-related costs. Because these costs are not being pushed down to customers, it is not appropriate to expend the very substantial funds and resources necessary to attempt to quantify offsetting benefits. If Berkshire were required to make adjustments for post-merger actions/benefits as

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[26] See also North Attleboro Gas Company, D.T.E. 00-26 (2000), where the Department found the 2.8 book value ratio to be acceptable and expressly noted that between 1997 and 1999, the book value ratio for gas company acquisitions was between 2.2 and 3.1 with an average of 2.7. Id. at 16-19. See also D.T.E. 00-25 (Fall River book value ratio 2.8 approved); D.T.E. 98-128 (Colonial Gas book value ratio 2.66 approved).

[27] See e.g. Eastern/Colonial Gas, D.T.E. 98-128 (transaction and system integration costs of $28.9 million); Boston Edison et al., D.T.E. 99-19 (transaction costs of $24,155,000); Eastern Essex, D.T.E. 98-27 ($7,605,000 in transaction costs and $7,394,000 in merger integration costs).

argued for by the Attorney General, then it would also be necessary to roll in **all** of the merger-related costs and higher expenses incurred to achieve these benefits. Berkshire's PCM Plan, utilizing a consistent incentive ratemaking approach, avoids the inclusion of all of these costs, which is to the ultimate benefit of customers.

III. CAST OFF RATES – COST OF SERVICE ANALYSIS

A. Rate Base

1. Whately LNG Plant

The Company's Initial Brief demonstrated that the new liquefied natural gas ("LNG") plant in Whately should be included within rate base. The Company supported such treatment based upon two essential arguments: first, the fact that the Department had fully considered and reviewed the need for, and the merits of, constructing the LNG facility; and second, the evidentiary record in this proceeding confirmed the Department's earlier findings. Co. In. Br., pp. 62-68.

The first and, indeed, compelling basis for inclusion of the LNG facility in rate base is the comprehensive, sophisticated and expert analyses that have previously been relied upon and accepted by the Department. In the Department's review of Berkshire's most recent forecast and supply plan filing, substantial consideration was devoted to the then-planned LNG facility. The Department found that the Company's analyses had resulted in the "identification of a resource that would contribute to a least-cost supply plan." Berkshire Gas Company, D.T.E. 98-99, p. 44 (1999). In addition, in the consideration of the appropriateness of the construction and operation of the LNG facility, the Department was presented with substantial evidence on need, project alternatives and alternative sites for the facility. See Berkshire Gas Company, D.T.E. 99-17/EFSB 99-2 (1999). The Department ultimately found that the LNG facility provides "a necessary energy supply for the Commonwealth with a minimum impact upon the environment at the lowest possible cost." Id. at 87. The Department found the need for the LNG facility to be immediate and urgent. The facility was found to be needed for the 99/00 winter in a decision issued on September 13, 1999. Berkshire completed the facility in January 2000 and such facility actually was instrumental in maintaining system reliability several days later. The Attorney General does not, indeed cannot, present any argument that can explain how the Department's express findings with respect to the plant may be ignored. As the Company noted, these decisions alone are sufficient to support the Company's proposal for the rate base treatment of the plant. Co. In. Br., pp. 62-64.

In terms of the evidentiary presentation, the Company described the new facility in its initial filing, during cross-examination and in the form of the presentation of a substantial portion of its earlier analysis as to need and project alternatives. Exh. BG-1, p. 11; Tr. 7, pp. 829-32; Tr. 15, pp. 1695-96; Tr. 16, pp. 1856-58; Exh. AG 12-17. Indeed, Exhibit AG 12-17 describes in appropriate detail the urgent need for the facility, the nature of the Company's analyses and the accepted conclusion that the LNG facility alternative was, by far, the least cost, most reliable alternative to address the identified "need" and that such alternative had the least overall impact upon the environment. See also Berkshire Gas, D.T.E. 99-17/EFSB 99-2. [28]

[28] The Attorney General could not mount any substantive challenges to this evidence. Having failed to present any substantive challenges, the Attorney General instead relies upon a stand-by, procedural argument that such evidence was somehow presented late or, in the words of the Attorney General, "more than two weeks after the close of discovery." AG Rep. Br., p. 20. Of course, the facts present a different story. The Attorney General did not issue his twelfth set of information requests (that, in part, addressed issues relating to the LNG facility) until after the close of business on September 27, 2001 (Email received by Company counsel at 6:20 p.m.), more than ten weeks after the date of the Company's Initial Filing. In accordance with the ground rules established in this case, responses to such information requests were not due to be filed until October 15, 2001. In fact, the relevant response was filed three days **before** its due date, on October 12, 2001. Following the receipt of these materials, the

In sum, the Company has demonstrated that, consistent with fully considered Department precedent as well as the evidence presented in this proceeding, the LNG facility should be included in rate base.

2. Greenfield Portable LNG Facility

The Company demonstrated that the portable LNG vaporizer, which it has long used for dispatch from its Greenfield Service Center and which continues to provide reliability benefits, should remain in rate base. Co. In. Br., p. 68. The Company cited the Department's decision in its most recent base rate case, where the Department held that it "will not allow relitigation of the prudence, or used and usefulness of an investment once it has been included in a Company's rate base." Berkshire Gas, D.P.U. 92-210, p. 22 (emphasis added). In reply, the Attorney General persists in flaunting this clear Department precedent in arguing (without record support) that the plant is not "active" and, therefore, not used and useful. AG Rep. Br., p. 21. Moreover, the Attorney General speculates that it is appropriate to distinguish between certain types of property, such as the vaporizer and inactive services, when making such after the fact arguments. Id. The Attorney General never addresses the clear Department precedent on this matter that makes no such distinction with respect to property type and precludes this very kind of after the fact review of "use and usefulness."[29] Accordingly, the Department should reject the Attorney

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Attorney General had ample time to examine Company witnesses regarding these matters. The Attorney General also suggests that the Company relied upon evidence from the record in other proceedings. AG Rep. Br., p. 20. It is significant that this argument is made without citation to any specific assertions. The Company's Initial Brief contained comprehensive and complete citation to the record or to relevant Department findings or precedent.

[29] Importantly, the Attorney General's arguments ignore the requirements of utility accounting. If the LNG vaporizer was found to have been retired during the test year, the net impact upon rate base would be zero. At any such retirement, the Company would debit the reserve for depreciation and credit the fixed asset cost for the same amount, thereby resulting in no net change to rate base.

General's arguments with respect to the rate treatment of the portable LNG vaporizer, which continues to provide benefits in the Greenfield Division.

3. Allocation of Propane Plant

The Company's Initial Brief demonstrated that the Company had properly allocated costs associated with certain propane storage tanks in a manner consistent with Department precedent. The tanks in question have not been sold by Berkshire, but are maintained as critical components of the Company's resource portfolio on peak or design days. The Company is proposing that **only** five percent of the costs associated with the tanks be assigned to utility customers. Co. In. Br., pp. 69-70. The Company noted that the propane tanks were all old and that several had been fully depreciated. Id. Moreover, the Company still maintains first priority to the use of the tanks while the retail propane operation must always come second. Id. at 69.

The Attorney General's argument against this rather modest allocation of costs is based upon two fictions. First, the Attorney General creates a "sale" where none exists. As noted, the Company has not sold the propane tanks. Title remains with the Company and such tanks remain necessary for reliability purposes. Exh. BG-8, p. 12; Tr. 16, pp. 1859-60. Second, the Attorney General creates a "price" for these largely depreciated assets based misleadingly (albeit creatively) upon the amount of goodwill allocated to the Company. AG Rep. Br., p. 22. As explained by the Company in its Initial Brief, goodwill generally reflects value of an enterprise as a going concern and cannot be translated into a valuation for any particular asset. Further, in this case, the Company's goodwill was **not** based upon any appraisal. Co. In. Br., p. 70. Last, if the Attorney General's argument is taken to its logical conclusion, goodwill values should be applied in the establishment of base rate valuations for the Company and its assets – a circumstance the Attorney General has strenuously opposed. Cf. AG Rep. Br., pp. 6-9.

In sum, the Company's proposed allocation of costs for the propane tanks is appropriate.[30]

4. **Cash Working Capital**

The Company's Initial Brief demonstrated two fundamental points with respect to cash working capital: first, the Company appropriately applied the traditional 45-day convention for calculating cash working capital for **base rates** based upon the results of a detailed cost-effectiveness analysis that demonstrated that performing a full lead/lag analysis was not cost-effective; and second, the Company demonstrated that its purchased gas lead/lag analysis appropriately reflects the cash working capital associated with purchased gas. Co. In. Br., pp. 71-73; Exh. BG-6, Sched. 4; Exh. BG-26, Sched. JMB-4

In his Reply Brief, the Attorney General persists in a clearly erroneous argument, namely that the Company employed a lead/lag analysis in calculating its base rate cash working capital requirement. AG Rep. Br., pp. 22-23. The fact that the Attorney General continues with this clearly erroneous argument should be viewed only as an attempt to mislead the Department. The Attorney General has not addressed at all the Company's cost-effectiveness analysis. Accordingly, for all the reasons stated in the Company's Initial Brief and evidentiary presentation, the Department should accept the Company's application of the 45-day convention for determining its base rate working capital requirement.

In terms of the Company's purchased gas working capital analysis, the Company demonstrated that the results of that lead/lag study were appropriate and consistent with Department precedent from the Company's last rate case. Co. In. Br., pp. 71-73; Exh. BG-26, Sched. JMB-4 (The Company demonstrated that the lag period for purchased gas costs has

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[30] At the most, the Department should simply remove the remaining value of the tanks from rate base. There is absolutely no factual or precedental basis for the Attorney General's attempt to generate a windfall through the manufactured 287% price estimate. See AG Rep. Br., p. 22.

decreased from the 31.6 days established in the Company's last rate order to 29.10 days.); cf. Berkshire Gas, D.P.U. 92-210, pp. 58-59. The Attorney General challenges only the billing lag component of the purchased gas analysis (i.e., the period from meter reading to billing). The Attorney General argues that because of the enhanced automated meter reading equipment installed by the Company, one of the many tasks required to be performed during this period is now done almost instantaneously through a data exchange between the meter reading computer and the billing computer system. AG Rep. Br., pp. 22-23. The Attorney General makes too much out of this enhancement and completely disregards a number of other tasks or contingencies that affect the time necessary to complete the billing process. As noted by the Company, the Attorney General's argument assumes **zero** time for: any analysis of meter reading data for validity, accuracy, consistency with past usage at the location; any analysis of high, low or missed reads; the necessary transfer of the bill to the printing vendor; the printing of the bills; the review of the printed bills; the analysis of any bills to hold; the processing of bills into envelopes; or the delivery of bills to the post office for mailing. Co. In. Br., p. 73. Moreover, the Attorney General's argument makes no provision for weekend days occurring during this process. Id. The Attorney General's argument is fundamentally flawed and, accordingly, the Department should accept the Company's purchased gas cost lead/lag analysis for calculating working capital related to purchased gas.

B. Revenue

1. Farm Discount

The Company's Initial Brief explained its proposed adjustment to revenues to reflect the recovery of the deferred farm discount credit. Co. In. Br., p. 75. The Company explained that test year revenues reflect the discount, but that the accumulated discount from the 1997 enactment of the mandatory discount needed to be amortized. The Company presented the determination of the appropriate adjustment in Schedule JJK-22. Exh. BG-6.

The Attorney General's Reply Brief mischaracterizes the factual and precedential bases for the Company's request. First, the Attorney General analogizes the farm discount to other subsidies recoverable through rates such as the low-income customer discount. AG Rep. Br., p. 37. As a general matter, the Company agrees with the Attorney General's characterization and notes that, on a "going forward" basis, the farm discount and the low-income customer discount are treated comparably. Exh. BG-16, Sched. PMN-6.

As to historic discount amounts, the farm discount, on the other hand, was established in 1997 without **any** adjustment to other base rates that would provide the Company with the opportunity to recover this mandatory subsidy. The Department traditionally "allows recovery of the low-income subsidy via base rate charges to other ratepayers." Blackstone Gas Company, D.T.E. 01-50, p. 35 (2001). No compensatory charges were made to other base rates at the time of the establishment of the farm discount. Thus, absent the Company's proposed adjustment, the farm discount would constitute confiscatory ratemaking. See Boston Edison Co. v. Department of Public Utilities, 375 Mass 1, 10 (1978).

Second, the Attorney General argued that the Company's request to reflect the pre-test-year discount levels in rates is somehow procedurally flawed because "apparently the Company failed to petition the Department for approval of deferral treatment . . . ." AG Rep. Br., p. 37. This assertion is remarkable given the Attorney General's citation on the same page of his Reply Brief of the Department's decision in Farm Discounts, D.T.E. 98-47 (1998). In that decision, the Department addressed a number of issues relating to the mandatory farm discount **including**

Berkshire's request for the "deferral of any underrecovery associated with the implementation of the Farm Discount . . . ." Id. at 2. The Department expressly noted that:

> Gas distribution companies may experience under-recoveries associated with implementation of the Farm Discount. In our earlier proceedings applicable to electric distribution companies, **we allowed deferral** of these Farm Discount costs for future consideration in a subsequent general rate case. See 220 C.M.R. [§ 11.04(b)]. There is no reason to treat gas distribution companies any differently. Therefore, we find that the gas distribution companies may defer costs associated with the implementation of the Farm Discount for consideration in a subsequent general rate case.
>
> Finally, because the Department will accord **all** gas distribution companies the opportunity to defer and recover Farm Discount expenses, we deny Berkshire's specific request that it be allowed to defer implementation of the Farm Discount until its expenses associated with the program can be recovered through its new [alternative] LDAC [proposed by Berkshire].

Id. at 5-6 (emphasis added and note omitted). Thus, the Attorney General's procedural arguments with respect to the Farm Discount subsidy can be readily dismissed.[31]

2. Reclassification of Demand Rates

The Company's Initial Brief demonstrated that an adjustment to test year revenues was necessary and appropriate in order to reflect the elimination of certain "demand" rates. Co. In. Br., pp. 75-76. In reply, the Attorney General merely recites the fact that the case cited by the Company to support the proposed adjustment, Fitchburg Gas, D.T.E. 99-118, involved the revenue treatment of a lost customer that had been served pursuant to demand rates and where

[31] The Company submits that the four-year amortization of the farm discount is appropriate. Interestingly, in arguing for a ten-year amortization of the farm discount, the Attorney General implicitly accepts the ten-year term of the PCM. AG Rep.. Br., p. 36, n. 33. As described in the Company's Initial Brief, the Company's cast off rates have been established on a stand alone basis. Co. In. Br., pp. 110-111. Berkshire would not be able to commit to a 10-year rate case "stay out" absent the merger with Energy East. The Department should therefore treat the amortization of farm discounts as if Berkshire remained a stand alone entity and approve the four-year amortization proposed by the Company as that is the average time between the Company's last four base rate cases. Cf. Co. In. Br., pp. 110-11.

the relevant demand charge was the primary determinant of charges to the customer. Cf. AG Rep. Br., p. 17; Fitchburg Gas, D.T.E. 99-118, p. 17.[32]

The Company has merely explained that the change from a demand rate to a "ccf" or "therm" rate, absent appropriate adjustment, may not lead to the appropriate revenue requirement. Fitchburg Gas, D.T.E. 99-118, p. 17 (A kwh analysis provided an "insufficient basis" to evaluate the revenue requirement effect of a lost customer). The Company's point is that this fact necessarily holds true for evaluating revenue requirements in a number of circumstances, including both the Fitchburg circumstance and this case. Accordingly, the Company's adjustment for the closure of demand rates in establishing the appropriate revenue requirement is reasonable and necessary.

3. Unbilled Revenue.

The Company's Initial Brief demonstrated that the Company's proposal to adjust test year revenues for unbilled revenues was appropriate. The Company demonstrated that its unbilled revenue adjustment appropriately reflected actual experience and was consistent with how revenues were booked during the test year. Moreover, the Company explained that its approach avoids the problems associated with the Attorney General's alternative proposal, namely "layer cake" estimation. Co. In. Br., pp. 77-78. The Attorney General has offered no

[32] The Attorney General also suggests a "curious disparity" in the Company's analysis of the bill impact of this adjustment. AG Rep. Br., pp. 16-17, n. 19. This assertion reflects either the Attorney General's confusion or a disregard for the record evidence. As noted in Exhibit DTE 3-9, a total of 19 customers received service pursuant to the Company's quasi-firm transportation rates. However, two customers were provided service pursuant to the Q-54 rate that is **not** being closed. Further, the Company's response to AG-RR-24 demonstrates that two additional Q-43 customers switched to volumetric rates in 2001. Thus, the Company's customer bill impact analysis of the effect of the change from demand rates appropriately considers only 15 customers. Hardly a curiosity.

new arguments in his Reply Brief. Accordingly, the Company's unbilled revenue adjustment reflected in Schedule JJK-35 of Exhibit BG-6 is reasonable and appropriate.

C. Expenses

1. Payroll Expense

The Attorney General continues in his Reply Brief to contest only the Company's proposed adjustments to executive compensation for 2001 and the inclusion of the departed executives' annualized salaries in the test year. AG Rep. Br., pp. 23-26. The Attorney General continues to be wrong on both scores.

a. Executive Increase, 2001

In its Initial Brief, the Company showed that the 11.7% increase[33] for executives in 2001 has already been implemented and thus is known and measurable; that the requisite correlation exists between this increase and the union increase; and that the increase is reasonable. Co. In. Br., pp. 82-84.

The Attorney General, in his Reply Brief, concedes an historical "relationship" between the Company's union increases and executive increases but questions whether this historical relationship amounts to a "correlation" justifying the increase proposed here. AG Rep. Br., p. 24. The Company suggests, again, that the pattern of increases over the past nine years of the Company's experience establishes the relevant correlation and fully supports the 2001 executive increase. Co. In. Br., pp. 86-87; Exh. BG-7, Supp. Sched. D.

[33] Again, as discussed in the Company's Initial Brief, this 11.7% figure is actually overstated on a percentage basis, because it does not take into account the salary of the one executive whose compensation did not increase at all between year-end 2000 and January 1, 2001, i.e., whose increase was 0%. See Co. In. Br., p. 88 n. 59.

The Attorney General also, in his Initial Brief, claimed that the Company provided no study to show that the 2001 increase in executive compensation is reasonable. AG In. Br., pp. 29-30. Having been pointed in the Company's Initial Brief to the CFS study of executive compensation that does precisely that,[34] the Attorney General now claims in his Reply Brief that the CFS study is flawed in two ways. AG Rep. Br., p. 24.

First, the Attorney General maintains that "the study used companies with annual revenues five times higher than those of Berkshire, obviously biasing the results and the executive compensation requirements upwards." AG Rep. Br., p. 24. In fact, however, the CFS study employed "[c]ompanies with revenues <u>under</u> $250 million <u>with a central tendency in the $50 – 100M range</u>." DTE-RR-34 (confidential attachment, p. 4). Thus, contrary to the Attorney General's assertion, the CFS study examined the compensation structures of companies with revenues comparable to Berkshire's.

Second, the Attorney General maintains that the CFS findings are biased upwards because CFS assumed a mix of 80% utility, 20% non-utility functions, while the Company's utility operations represent more than 92% of Berkshire Energy Resources' operations. AG Rep. Br., p. 24; <u>see</u> <u>also</u> DTE-RR-34 (confidential attachment, p. 4). The Attorney General's record cite for this 92% figure, however, is the information request in which the Company provided the workpapers and calculations relevant to determining the **goodwill** associated with the Company, BER, and the Company's affiliates. AG Rep. Br., pp. 24-25; Exh. AG 10-12. The appropriate analysis, of course, is of the split in the Company's **payroll** between utility and non-utility functions. A rough estimate of that split can be determined by reference to the

[34] <u>See</u> Co. In. Br., p. 87; DTE-RR-34 (confidential attachment).

figures appearing in Supplemental Schedule NU-F to Mr. Kruszyna's pre-filed testimony for payroll attributable to utility functions and utility capital versus total payroll: $5,496,915 + $847,221 / $7,683,613 = 82%. Thus, the split assumed in the CFS study is entirely appropriate.

In sum, neither of the Attorney General's complaints regarding the CFS study bears scrutiny. As shown in the Company's Initial Brief, the CFS study establishes that the 2001 increases in executive compensation do not even bring the Company's executives to the mid-points of the salary ranges that CFS established based on the **1999** market, and therefore the 2001 increase of $29,500 plainly is reasonable and should be approved by the Department. See Co. In. Br., p. 87; compare Exh. AG 5-4 (setting forth 2001 executive salaries) with DTE-RR-34 (confidential attachment, p. 13)(setting forth recommended salary ranges based on 1999 market).

b. Inclusion of Messrs. Robinson's and Marrone's Compensation

The Attorney General continues to argue in his Reply Brief against including in the test year cost of service the annualized salaries of the Company's two departed executives, Scott Robinson and Michael Marrone. AG Rep. Br., pp. 25-26.[35] As the Company demonstrated in its Initial Brief, however, such treatment is necessary to accurately present the Company's cost of service on a pre-merger, stand alone basis, a feature integral to the Company's PCM Plan. Co. In. Br., p. 88; see also Section II. F., supra. The Attorney General's primary argument against including these salaries in the test year cost of service is that the Company has not

[35] The Attorney General apparently recognizes that he was wrong in his Initial Brief in claiming that the Company's proposed executive increases for 2001 and 2002 include increases for Messrs. Robinson and Marrone. Compare AG In. Br., p. 31, with AG Rep. Br., pp. 25-26; see also Co. In. Br., pp. 88-89.

shown any basis for this stand alone treatment. AG Rep. Br., p. 25. That, of course, is not true. Quite to the contrary, the Company has presented an overwhelming case in support of its PCM Plan in general and its proposal that the Company be treated on a stand alone basis for ratemaking purposes in particular. See Section II. F., supra. [36]

Accordingly, the annualized salaries of Messrs. Robinson and Marrone are appropriately included in the test year cost of service and the failure to reflect such salaries in the cast off rates would seriously impair the Company's carefully balanced PCM Plan.

2. Health Care Adjustment

The Company demonstrated in its Initial Brief that both its test year health care expense attributable to utility O&M and its proposed health care expense adjustments for 2001 and 2002 are appropriate and should be included in its cost of service. Co. In. Br., pp. 89-93. In his Reply Brief, the Attorney General, while still not contesting the test year health care expense, continues to argue for total post-test year adjustments of only $826, based on the same flawed analysis he advanced in his Initial Brief. See AG In. Br., pp. 34-36; AG Rep. Br., pp. 26-28.

As the Company showed in its Initial Brief, the Attorney General's calculation of the 2001 and 2002 adjustments is infected by two fundamental errors. First, the Attorney General's claim that the Gallagher estimates of percentage increases in health care expenses are unreliable is simply belied by the record evidence. Co. In. Br., pp. 91-92. The

[36] The Attorney General also argues that the only cost savings the Company has shown are through the early retirements of these two executives, but that both were then replaced by other employees who received substantial salary increases. AG Rep. Br. p. 25. In fact, however, both of these employees were already Company executives who assumed additional duties and whose salaries are still significantly below those of the departed executives. See Exh. AG 5-4.

uncontroverted testimony of Mr. Kruszyna establishes that, as of the end of September 2001, the increase in health care expense for 2001, on an annualized basis, was **at least** as great as, if not greater than, the $89,253 predicted by employing the 9.35% rate of increase forecast by Gallagher for fiscal year 2001. Tr. 9, p. 1008; Tr. 14, p. 1567. While the Attorney General now complains that "[f]rankly, [he] has not seen any of these numbers," AG Rep. Br., p. 26, he **has** seen Mr. Kruszyna's testimony, and has provided no basis for rejecting it. Moreover, as the Company represented in its initial filing, it is updating Schedule JJK-32 to Mr. Kruszyna's pre-filed testimony – a proposal with which the Attorney General has taken no issue during these proceedings – and thus the Company expects the record at the close of the case to establish beyond peradventure a known and measurable increase for 2001 of at least the proposed $89,253. See Exh. BG-5, p. 25; Co. In. Br., p. 92 n. 60.[37]

The Company also demonstrated in its Initial Brief that, in proposing a total adjustment to test year health care expense of $826, the Attorney General not only invoked an artificially-low rate of increase but also double-counted the allocations for non-utility Rentals and Merchandising and Jobbing. Co. In. Br., pp. 92-93. The Attorney General, rather than concede this rather obvious mistake, instead accuses the Company in his Reply Brief of fundamentally misunderstanding its own accounting and proposed adjustment. AG Rep. Br., p. 27. In so doing, the Attorney General engages in an exercise of pure legerdemain.

[37] The Attorney General accuses the Company of interjecting a red herring by pointing out that its proposed adjustments are based on a calendar year rather than a fiscal year. See AG Rep. Br., p. 30. It is, however, the Attorney General who has confused the record by recommending that an artificially-low rate of increase calculated by reference to fiscal year figures, 4.73%, be employed in the face of uncontroverted evidence that the known and measurable increase for 2001 is at least the $89,253 recommended by the Company. Importantly, the test year was the calendar year 2000.

Specifically, notwithstanding that this nowhere is stated in his Initial Brief, he now claims that his proposed $826 increase is to be added to $955,600 rather than the test year expense attributable to utility O&M of $920,106. Id. In so doing, the Attorney General appears to be accusing the Company of failing to remove amounts allocable to Rentals and Merchandising and Jobbing from its test year health care expense – that is, of failing to remove from the test year total the $6,694 allocable to Rentals and the $28,800 allocable to Merchandise/Jobbing. Id. & n. 24. This is not so, as Supplemental Schedule NU-F to Mr. Kruszyna's pre-filed testimony makes clear. See Exh. BG-9, Sched. NU-F, line 18 (medical expense for utility operations reported as $920,106); Co. In. Br., p. 89 (same).

At bottom, however, it does not matter. By claiming that his intent was to add his $826 health care adjustment to $955,600 rather than the test year amount of $920,106, the Attorney General is tacitly conceding that, even by his own calculation, his $826 adjustment for 2001 and 2002 is understated by $35,494 ($955,600 - $920,106).

Accordingly, nothing contained in the Attorney General's Reply Brief undermines the Company's position that its proposed 2001 and 2002 health care adjustments are fully supported by the record and should be included in the Company's cost of service.

3. Labor Contract Contingency Expense

The Company demonstrated in its Initial Brief that it expects to incur a labor contract contingency expense every three years, each time it negotiates a union contract, and therefore the Company seeks to include in cost of service one third of the $162,436 it incurred for this purpose, or $54,140. Co. In. Br., pp. 93-94. The Company further demonstrated that, by incurring this expense, the Company prepares itself to safeguard its assets and run its business in the event of a strike, an exercise that enables it to negotiate with the union from a position of reasonable strength and hence, consistent with Department directives, to pursue an overall labor-management strategy to minimize unit labor costs while maintaining safe and reliable service for customers. Id.

In his Reply Brief, the Attorney General, while not contesting the value of this expense in helping to minimize labor costs – indeed, while "agree[ing] with the Company that it should always have a plan in place to protect its assets and employees in the case of a strike" – nonetheless continues to oppose inclusion of the proposed adjustment in the Company's cost of service. AG Rep. Br., p. 29. Unfortunately, having a plan in place without expending the funds necessary to carry it out in the event of a strike is not particularly effective, either in terms of negotiating with the union to hold down labor costs or in terms of running the business and protecting employees and assets in the event of a strike. The Company incurred these expenses in 1996, when it negotiated its last union contract; the Company incurred them again in the test year,[38] when it negotiated the current union contract; and the Company expects to continue to incur them approximately every three years, each time it negotiates a union contract in the future. See Co. In. Br., p. 94.

Thus, the Department should approve the Company's proposal to normalize its test year expense of $162,436 over three years, and to include one third of that amount, or $54,140, in cost of service.

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[38] The Company's test year expenditures were prudent and necessary, as the Company did experience a job action. Co. In. Br., p. 94.

4. 401(k) Plan Costs

The Company's Initial Brief described the appropriate adjustment to 401(k) costs and the fact that the Attorney General's Initial Brief had overstated the adjustment. Co. In. Br., pp. 95-96. The Company described how the appropriate payroll allocation had been developed for non-utility operations and utility capital by the application of total payroll-related expenses in the denominator (i.e., $7,683,613) and the relevant category (e.g., capital-related payroll) in the numerator.[39] In his Reply Brief, the Attorney General suggests that no 401(k) costs are allocated to conservation and Load Management, Energy Conservation Services and clearing accounts. AG Rep. Br., p. 28. A cursory review of Supplemental Schedule NU-F, line 32 demonstrates that total payroll includes the $678,509 ($57,603 + $620,906) allocated to these factors. As noted in the Company's Initial Brief, the Company has reflected appropriate adjustments to 401(k) expense in the rate schedules provided as Attachment A to this Reply Brief.

5. Severance Payments

The Company's Initial Brief described the appropriate treatment accorded to the costs associated with two vehicles transferred to departing officers upon the consummation of the merger. Co. In. Br., pp. 96-97. The Company explained that the cost of one vehicle had been charged to the liability account for the change of control and, thus, had not been reflected in Mr. Kruszyna's cost of service analysis in this case. The Company agreed to make an adjustment to officers' expense with respect to the sale of the second vehicle. Id. In his Reply Brief the Attorney General suggests that it is appropriate to require the "return" of the market value to customers. AG Rep. Br., p. 29. In fact, given the Company's proposed treatment of these

[39] The Company notes that if the Attorney General's arguments are accepted and additional 401(k) expenses are allocated to "capital," then corresponding adjustments must be made to the rate base calculation and depreciation expense calculation.

transactions, there is nothing to "return." Ratepayers have not borne the costs of these transactions. No severance payments are reflected in the Company's proposed cost of service. Accordingly, the Department should accept the Company's proposed treatment of these transactions.

6. **Consultant Fees Expense**

The Company's Initial Brief demonstrated that the Company has properly reflected required consulting payments to a former chief executive officer, Mr. Joseph Kelley, in its cost of service analysis. Co. In. Br., pp. 97-98. The Attorney General's Reply Brief rehashes the arguments from his Initial Brief and, most tellingly, does not even attempt to address the Department's previous allowance of this expense in Berkshire Gas, D.P.U. 92-210 as cited in the Company's Initial Brief. Accordingly, the Company's reflection of Mr. Kelley's consulting fees in its cost of service analysis is appropriate.

7. **Supplemental Executive Retirement Plan**

The Company's Initial Brief described how its cast off rates reflected a normalized and independently-established level of payments associated with the Company's Supplemental Executive Retirement Program, or "SERP." In his Initial Brief, the Attorney General argues for the elimination of "accelerated payments" caused by the merger and the reduction of the cost of service by $285,153. AG In. Br., p. 50. The Company's Initial Brief explained the Attorney General's apparent confusion in referring to the $285,153 reflected in cost of service as an "accelerated payment." Co. In. Br., p. 98. The Attorney General, while critical of the Company's demonstration of the inconsistency of his arguments (see AG Rep. Br., p. 34, n. 29), corrects his argument in his Reply Brief. The Attorney General then argues, without **any** record support, that all SERP-related expenditures should be excluded from cost of service because such payments were purportedly unrelated to utility operations and service. AG Rep. Br., p. 34.[40]

The record evidence, however, demonstrates the reasonableness of the SERP and the fact that such plans are a standard component of utility executive compensation. The SERP was established in 1996 in order to attract and retain critical executive employees. Exh. BG-5, pp. 22-23; Exh. BG-7, Supp. Sched. G; Tr. 9, pp. 1000-01. Further, the SERP was merely a component of the overall compensation package to executives. The Company has demonstrated that its overall executive compensation was substantially below market. DTE-RR-34 (confidential attachment). Further, the Company's 1999 analysis of executive compensation also compared typical SERP plans for other utilities and found that the Company's SERP was a comparatively "modest plan." Id. at 9.

The Department's well-established practice is not to focus on particular components of a compensation package, recognizing that the components of compensation are "substitutes for each other, and different combinations of these components may be used to attract and retain employees." Boston Gas, D.P.U. 96-50 (Phase I), p. 47; Cambridge Electric Light Company, D.P.U. 92-250, p. 55 (1993). The Department has found that "the individual components of compensation packages are appropriately left to a company's management." Id. In this case, the Company has demonstrated that it has successfully pursued a strategy to contain total labor costs. Moreover, executive compensation has been shown to be manifestly reasonable. Co. In. Br., pp. 82-84; Section III.C.1.a, supra. Accordingly, the Department should disregard the Attorney

[40] The Attorney General also argues, again without support, that the SERP was adopted in 1998 in anticipation of the 2000 merger. AG Rep. Br., p. 34. In fact, the SERP was adopted August 22, 1996. Exh. BG-7, Supp. Sched. G.

General's arguments with respect to the SERP and accept the Company's inclusion of a conservative, independently-established, normalized SERP payment.

8. Environmental Remediation Costs

As discussed in the Company's Initial Brief, the Company seeks to include in test year cost of service $103,719 in environmental remediation costs. Co. In. Br., pp. 99-101. As the Company demonstrated, the Company and other LDCs entered into a settlement in the early 1990's in the proceeding entitled Generic Investigation of the Facts Surrounding and the Ratemaking Treatment of the Costs of Investigating and Remediating Hazardous Wastes Associated with the Manufacture of Gas During the Period 1822-1978, D.P.U. 89-161 (1990). Id. This settlement, among other things, provides that an LDC such as the Company can amortize environmental costs incurred in a particular year over seven years, without carrying costs, and less the amount of a deferred tax benefit, and recover that amount through the LDAC. Id. Neither the Department nor the parties anticipated that there would be circumstances in which no deferred tax benefit would be available. Id. Such is the case, however, with respect to the $103,719: because the Company did not cause the pollution requiring the remediation in question but instead purchased land that subsequently proved to be polluted, the Company, under the Internal Revenue Code, was not able to achieve deferred tax benefits. Id.; AG-RR-30.[41] Accordingly, the Company seeks to include this amount in its test

[41] The Attorney General complains that the Company has provided no written documentation supporting the specific advice given regarding the non-deductibility of these remediation costs. AG Rep. Br., p. 33 n. 27. In fact, the Company provided a written response to a record request of the Attorney General setting forth the advice it received from Mr. Paul Harris, a specialist in utility taxation, together with materials from the CCH Tax Service and Deloitte & Touche corroborating Mr. Harris's advice. AG-RR-30. Mr. Harris himself, unfortunately, is deceased, and thus the Company was simply not able to obtain current written documentation from him. AG-RR-30.

year cost of service, a proposal that simply enables it to recover, consistent with the public policy goals of D.P.U. 89-161, the amount unavailable to the Company either as a deferred tax benefit or through the LDAC.

The Attorney General does not quarrel in his Reply Brief with the proposition that the Department and the parties to D.P.U. 89-161 anticipated that LDCs would be able to recover the full one-seventh of a particular year's remediation costs, either through the LDAC or in the form of deferred tax benefits, and that the non-deductibility of remediation expenses for purchased property was unforeseen. Instead, the Attorney General's primary point in reply appears to be that the record contains no details regarding the Company's purchase of the property in question, and that the Department should require the Company to establish the prudence of this investment before approving recovery of the attendant remediation costs. AG Rep. Br., p. 33. First, the property in question already is included in rate base, and therefore the Attorney General's suggested prudence inquiry is not necessary and, in fact, would be contrary to Department precedent. See Berkshire, 92-210, p. 22. Second, and in any event, nothing in D.P.U. 89-161 mandates such a prudence review before remediation costs can be recovered; indeed, requiring an LDC to make such a showing in each instance would be antithetical to the public policy underlying D.P.U. 89-161 of promoting prompt remediation of potentially hazardous conditions.

Accordingly, the Department should permit inclusion of this amount in the Company's test year cost of service.

9. **Rate Case Expense**

In its Initial Brief, the Company demonstrated that its rate case expense was reasonable, appropriate and established in a manner consistent with precedent. Berkshire also presented substantial evidence that it had pursued a number of initiatives to contain rate case expense.

In reply, the Attorney General raises only two points. First, he challenges the Company's legal fees, again arguing that the Company had not demonstrated why it had not pursued a competitive solicitation for legal services.[42] AG Rep. Br., p. 30. In fact, Ms. Zink's testimony and the Company's Initial Brief convincingly explains the basis for this decision. Tr. 14, p. 1520 et seq; Exh. BG-22, pp. 16-17; Co. In. Br., pp. 103-05. Simply put, Rich May offered extremely competitive rates for its services that reflected additional negotiated discounts; Rich May was familiar with the Company and recent projects or transactions that have been the subject of extensive investigation in this proceeding; and Rich May and the Company had been successful in working together to contain costs in other proceedings. Id.; see also Tr. 14, pp. 1524-28. In sum, there were substantial and compelling bases for the Company to continue to retain its counsel and the Company has fully satisfied the Department's standards in this regard. See Fitchburg Gas, D.T.E. 98-51, p. 60.

The Attorney General next seeks to imply that legal expenses for the rate case are not known and measurable. AG Rep. Br., pp. 30-31. The basis for this argument is a purported lack of detail in counsel's bills. The record evidence, however, shows that such bills contain information broken into six-minute increments for each matter, by attorney performing the services and the hourly rate of each such attorney. Id. Counsel further maintains detailed billing

[42] The Attorney General begins his reply argument on rate case expense with a confusing reference to a challenge to "test year legal fees." AG Rep. Br., p. 30. Rate case expenses were incurred **after** the test year.

back-up in six-minute increments in the event that further detail is requested by the Company. Further, as Ms. Zink testified, the Company and counsel have been in continual contact during the pendency of the rate case and the Company has a firm, real-time grasp on all legal projects that Rich May is performing. Cf. Tr. 14, pp. 1522-24.

Further, the Company has provided periodic updates on all rate case expense during this proceeding and the Department will be fully aware of total final legal expenses.[43] The Attorney General also disregards the fact that the Company's counsel provided a detailed estimate of legal expenses, based upon numerous assumptions described in substantial detail (that Ms. Zink was fully able to evaluate based upon her substantial rate case experience (Tr. 14, pp. 1522-23)). In challenging total expenses, the Attorney General also disregards the fact that until the Company was faced with more extensive discovery and hearing requirements than originally contemplated, new evidentiary requirements and extensive procedural filings (all of which had been identified as factors that would cause a deviation from the original estimate), **actual** legal expenses were **below** the original estimate. This is compelling evidence of the merits of the Company's approach.[44] Recent Department precedent has allowed for the recovery of legal expenses above

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[43] As stated numerous times during the evidentiary record, the Company will be providing an update to actual rate case expense, including legal expenses. Exh. BG-5, p. 29; see also Fitchburg Gas, D.T.E. 98-51, p. 56 ("The Department routinely permits the record to remain open after the close of hearings for receipt of updated information on rate case expense and other non-controversial items that have been examined adequately on the record."). An update will be filed shortly after the submission of this brief so that charges for December 2001 may be reflected.

[44] The Attorney General cites favorably to a brief, summary description provided in a bill from another attorney in connection with the Department's review of a gas purchasing alliance. AG Rep. Br., p. 36. The Attorney General's preferred management process provides no basis in an estimate to confirm that such charges were not excessive or that the relevant tasks were performed efficiently. Most importantly, the Attorney General does not describe the fact that the cited invoice was at a rate equivalent to 170% of the charges from Rich May for comparable services.

an original estimate even when, unlike in this case, no explanation was provided for such deviation. Blackstone Gas, D.T.E. 01-50, pp. 20-23 (Original estimate of $60,000 for legal expenses, final expenses estimated as $106,419 and the Department allowed for the recovery of $97,319).[45] Moreover, in Pinehills Water Company, D.T.E. 01-42, p. 15 (2001), the Department recognized that rate case expense should be considered in light of the "level of supporting information" required in a filing and in terms of "the characteristics of the discovery which the Company received." The Company has fully satisfied Department precedent with respect to the demonstration that its rate case expenses, including legal expenses, are known and measurable and reasonable. Accordingly, the Company's rate case legal expenses are clearly reasonable, especially when considered in the context of its comprehensive PCM filing addressing numerous cost of service, service quality, merger and rate design issues.

The Attorney General next goes on to challenge the charges of Management Applications Consulting ("MAC") in terms of the development of the Company's rate design. The Attorney General merely argues that the costs were higher than the original estimate and that the Company did not demonstrate the efforts applied to control costs in this area, primarily because there were numerous hearings involving these witnesses. First, the Attorney General ignores the fact that MAC performed additional services beyond those reflected in its estimate due to Berkshire's extremely lean staffing (essentially only three employees were primarily responsible for the full

[45] Berkshire also notes that it fully addressed the Department's recent directive that it pursue a variety of efforts to contain rate case expense "including undertaking settlement negotiations." Blackstone Gas, D.T.E. 01-50, p. 23. In fact, Berkshire pursued settlement negotiations in 2000 with the aim of avoiding a base rate case, pursued good faith settlement efforts in this proceeding and sought to reduce costs through a number of cost-effective initiatives including avoiding a productivity study, avoiding a lead/lag study for base rates and retaining consultants such as James Aikman with an eye toward efficiency as Mr. Aikman had performed each of the Company's depreciation studies over the last 20 years. Exh. BG-1, p. 9; Tr. 10, pp. 1126-28.

presentation of the case (Tr. 16, p. 1866)). See also, Blackstone Gas, D.T.E. 01-50, pp. 21-23. Second, the Attorney General disregarded the Company's requests that he schedule necessary examination of witnesses in a manner that would reduce the required time that MAC witnesses needed to attend hearings. See Co. In. Br., p. 109; Tr. 6, p. 675. For the Attorney General to argue for extra days of testimony and then later challenge the costs of such testimony (along with related consultant and legal costs and disbursements) is both disingenuous and offensive.[46] Accordingly the Department should reject the Attorney General's arguments with respect to MAC's reasonable charges for high quality services.

10. Depreciation Expense

a. Accounts 305 and 319.10 – Whately Plant

The Attorney General continues to complain in his Reply Brief that Mr. Aikman, rather than determine an average service life for the portions of the Whately LNG Plant booked to Accounts 305 and 319.10, should instead have simply used the average service lives developed for the other property booked to those accounts. AG Rep. Br., pp. 43-46. In so doing, the Attorney General, indignant at the Company's suggestion in its Initial Brief that the Attorney General's position lacks authority, now provides a string-cite of precedent for the proposition that actuarial studies are used in determining average service lives. See AG Rep. Br., p. 44.

The problem with this authority, of course, is that it misses the mark. The Company never said that actuarial studies are irrelevant to the process of determining depreciation

[46] The Company also categorically rejects the assertion that the Company engaged in any "stonewalling." AG Rep. Br., p. 37. The Company made its witnesses available on numerous additional days for hearings, provided discovery responses, on average, before their due dates, granted numerous revisions to the procedural schedule for the benefit of other parties (e.g., extra day to issue discovery, extra day for briefing, accepted essentially no time to review discovery responses from Attorney General's witness), and raised only very limited procedural matters.

accrual rates (although the results of such studies must be tempered by sound judgment and common sense); rather, in the hands of a seasoned expert such as Mr. Aikman, such studies are an important tool. See Co. In. Br., pp. 116-19.

What apparently has the Attorney General confused, however, is that in this case Mr. Aikman did not, and could not, perform an actuarial analysis with respect to the Whately LNG Plant, because the Whately Plant is **new.** See, e.g., Tr. 10, pp. 1105-08. Indeed, it was because, as Mr. Aikman testified before the Department, he had "absolutely no history to go by" that he performed a unit analysis – that is, he "took [the Whately Plant] apart" and estimated the lives of the various pieces. See Tr. 10, p. 1108. Accordingly, the Attorney General's suggestion that Mr. Aikman has somehow "deviate[d] from the actuarial analysis" is wrong, for the simple and sufficient reason that there was never any actuarial study of the Whately Plant to deviate from. See AG Rep. Br., p. 44. Thus, the Attorney General's string-cite of precedent concerning conclusions that vary from statistical analyses is, once again, wide of the mark. See id.

Moreover, the Attorney General's claim that the Company takes inconsistent positions with respect to these issues depending on whether they benefit or harm shareholders is simply wrong. The Attorney General claims that the Company and Mr. Aikman resist unit analysis with respect to Mains and Services in order to achieve a "major inflation" of the depreciation accrual rate, but choose to employ it with respect to the Whately Plant because, in that instance, it provides "faster recovery for shareholders." AG Rep. Br., p. 45. First, the Attorney General's claim in this respect with regard to Mains is particularly misplaced: Mr. Aikman actually recommended a longer average service life – 60 years – for Mains than the 56 to 59 years indicated by the actuarial studies – hardly the handiwork of a witness intent on inflating depreciation accrual rates. See Exh. BG-13, Report, p. 9 (discussion regarding Account 367 – Mains).

Second, and more fundamentally, the Company does have actuarial data for the property in Accounts 367 (Mains) and 380 (Services). See, e.g., Exh. BG-14, Tab 4, p. 2. Because the Whately Plant is brand new, such data were, perforce, unavailable, and accordingly Mr. Aikman undertook his unit analysis in order to estimate the Plant's service life.

The Attorney General has asked the Company, why have Mr. Aikman and why do actuarial studies? AG Rep. Br., pp. 43-44. As to the second question, the response is, as noted above, that such studies are an important tool, **assuming the necessary actuarial data exist**.

As to why retain Mr. Aikman, the Company cited extensive precedent in its Initial Brief for the proposition that, in addition to statistical analyses, it is important to rely on the judgment and expertise of witnesses such as Mr. Aikman. See Co. In. Br., pp. 113-15, 117-18. Indeed, not only has Mr. Aikman participated in many prior proceedings before the Department, Co. In. Br., p. 114, but the Department has explicitly recognized Mr. Aikman as a "well-seasoned expert in the field of depreciation" with "an appropriate understanding of the results generated by his computer program [who] possesses the engineering knowledge and experience appropriate to interpreting those results." Commonwealth Electric Company, D.P.U. 90-331, p. 52. Accordingly, when considering a brand new facility such as the Whately Plant, Mr. Aikman's recognized experience and expertise – experience and expertise that include significant familiarity with other LNG facilities – are particularly critical to determining an appropriate average service life. See Exh. BG-13, p. 7.

In sum, the premise of the Attorney General's arguments regarding Mr. Aikman's treatment of the Whately Plant – that he has ignored or deviated from actuarial analyses of the

Plant – is simply wrong, because there were no such analyses. The Attorney General still has cited no authority for the proposition that, when a major new facility such as the Whately Plant is built, a company is bound to employ the average service life developed for the other property in the account to which the new facility is booked, regardless of whether it is an accurate estimate of the service life of the new facility. Nor has the Attorney General cited any authority for the proposition that unit analyses, such as Mr. Aikman used to estimate the life of the Whately Plant, are inappropriate. Finally, the Attorney General still has not shown that any particular component of Mr. Aikman's unit analysis is wrong. Instead, the Attorney General, having chosen not to sponsor any expert in depreciation studies, let alone an expert with the credentials of Mr. Aikman, has relied on pejorative references to Mr. Aikman's careful analysis as a "back of the envelope number." AG Rep. Br., pp. 43, 45-46. The Department should reject the Attorney General's confused and misleading argument, which is wholly unsupported, and adopt the depreciation accrual rates recommended by the Company for the Whately Plant.

b. <u>Mains and Services</u>

The Attorney General, having just extolled the virtues of actuarial analyses, reverses field to propose that they be ignored with respect to Account 380 (Services). AG Rep. Br., pp. 46-47. Indeed, the Attorney General now seeks to expand this argument to include Account 367 (Mains). AG Rep. Br., pp. 46-47. In his initial brief, however, the Attorney General expressly represented that he sought no change in the Company's proposed 60-year life for Account 367. AG In. Br., p. 84. The Department should hold the Attorney General to his word and reject this unwarranted change of position, particularly given that the Attorney General's sole recommendation for an alternative ASL for this account is the rather vague and unhelpful suggestion that it be "much higher." AG Rep. Br., pp. 46-47.

In any event, the Attorney General is wrong for the same reasons advanced in the Company's Initial Brief. See Co. In. Br., p. 121. The premise underlying the Attorney General's argument is that the Company was somehow remiss – indeed, imprudent – for failing to recover the costs of "obviously defective products," i.e., certain tar-coated services. AG Rep. Br., p. 46. As the Company pointed out in its Initial Brief, however, the Department does not permit relitigation of the prudence of an investment once it has been included in rate base. E.g., Berkshire Gas, 92-210, p. 22. While the Attorney General argues that this precedent applies only to the inclusion of plant in rate base and not to its treatment for depreciation purposes thereafter, AG Rep. Br., p. 46, seeking unfavorable depreciation treatment on grounds of purported imprudence is simply a back-door way of seeking a similar end. The Attorney General has cited no authority for the proposition that a company's purported imprudence with respect to particular property should affect depreciation accrual rates.

Second, the Company pointed out that the record does not support the Attorney General's claim that the Company has acted imprudently. Co. In. Br., p. 121. To the contrary, the record shows that the problem with the tar-coated services did not manifest itself until almost twenty years after the Company had started using a different coating. See AG-RR-43. The Attorney General has not proffered even a scintilla of evidence to show that the Company could profitably have pursued the manufacturer(s) of the tar coating at that late date. Given that the record is devoid of anything beyond the Attorney General's ipse dixit to suggest that the Company acted imprudently, the Attorney General's recommended treatment of Services for depreciation purposes should be rejected.

Finally, the Company took issue in its Initial Brief with the Attorney General's suggestion that Department use as a proxy the 45-year average service life that the Department approved for a different company in a different case some three years ago. Co. In. Br., p. 121. The Attorney General responds that "the use of proxies to determine costs **in the absence of data** is a standard technique that the Department has employed when determining depreciation accrual rates . . . ." AG Rep. Br., p. 46 (emphasis added). All well and good, except that here there is no "absence of data": to the contrary, there are the data underlying the several actuarial analyses of Mr. Aikman, most of which indicate the service life for this account to be in the range of 35 to 39 years. Exh. BG-13, Report, p. 10. Thus, whatever the theoretical merits of using a 45-year service life borrowed from a different proceeding when data are lacking, use of such a proxy does, indeed, fly in the face of logic when data do exist and fully support the recommended 38-year service life. See Co. In. Br., p. 121; AG Rep. Br., p. 46.

Accordingly, the Department should reject the Attorney General's proposed 45-year service life for Services (as well as his belated, "much-higher-than-60-year" recommendation for Mains) and adopt the service lives proposed by the Company.

D. Capital Structure and Rate of Return

1. Introduction

In his Reply Brief, the Attorney General takes issue with the Company's well-documented demonstration in its Initial Brief of the many risks confronting it, cavalierly claiming that this "can all be dismissed with the recognition that the Company is still a monopoly provider of natural gas distribution services, a necessary service for the residences and business[es] in its geographic area." AG Rep. Br., p. 38. The Attorney General's position reflects a fundamental misunderstanding of the competitive forces confronting local distribution companies such as Berkshire. The Company will necessarily continue to compete with alternative energy providers. Just because the Company is the only gas distribution utility with an established infrastructure in its franchise service area does not mean that existing or potential customers are precluded from obtaining alternative energy from fuel oil, propane, electricity, and other sources. In addition, large volume users represent 66% of throughput on the Company's system (see Exh. BG-10, p. 2), and they face competitive pressure on their own operations (see Exh. BG-10, p. 13). Moreover, the Company's service territory has experienced a net loss of population, which further increases its business risk (Exh. BG-1, p. 13). These and other factors all point to high business risk for the Company.

The Attorney General also argues that the simple decrease in the cost of money since the Company's last rate case supports his recommendation of a 9.84% return on common equity. AG Rep. Br., p. 39. Mr. Moul, however, has convincingly demonstrated the many additional factors that impact the Company's cost of equity aside from changes in interest rates since the Company's last case. While it is true that the yields on 30-year Treasury bonds and A rated public utility bonds have decreased since that time, those elements cannot be viewed in isolation. See Tr. 5, p. 660. Since the Company's last rate case, both the beta and market premium components of the CAPM have increased. Tr. 5, p. 661. In addition, there has been a marked increased in the equity risk component of the Risk Premium analysis – i.e., from 4.75 percent in the 1992 case to 5.50 percent in this case. Tr. 5, p. 662. Further, the spread between the cost of corporate borrowing and the yield on Treasury bonds has expanded exponentially since the Company's last rate case. Indeed, the gap between the yield on A rated public utility bonds and long-term Treasury bonds has expanded from 1 percentage point in 1992 to 2.25 percentage points at the present time. This shows that the cost of corporate capital (i.e., debt and equity) remains high in relation to Treasury yields.

Not surprisingly, then, the AG's suggested 9.84% return on equity falls woefully short of providing a fair rate of return according to Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), and Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1942). With a 9.84% return on equity, the Company's overall rate of return would be just 9.13% (9.84% x .4189 = 4.12% + 4.99% + 0.02%). This would result in a pre-tax rate of return of just 11.70% (4.12% + 0.02% = 4.14% ÷ .6171 = 6.71% + 4.99%) and lead to pre-tax interest coverage of only 2.34 times (11.70% ÷ 4.99%). This would place the Company near the bottom of the range of 2.2 times to 3.3 times for the BBB bond rating. See Exh. BG-10, p. 18. If it were to experience any attrition in its return, the Company would quickly fall into the "junk bond" category for companies having pre-tax interest coverage below 2.2 times. There is no contingency provided in the Attorney General's proposed rate of return. In contrast, the Company's proposed rate of return would provide 2.71 times pre-tax interest coverage, see Exh. BG-10, p. 7 and BG-12, p. 1, which is approximately at the 2.75 times midpoint of the range for the BBB rating. Accordingly, the Company's proposed rate of return, unlike the Attorney General's proposal, satisfies the financial integrity standards of Bluefield and Hope.[47]

Finally, the Department should recognize the factors that distinguish Berkshire from other utilities considered by the Department in recent proceedings. Cf. Fitchburg Gas, D.T.E. 99-

[47] Even the Company's recommendation is conservative given the Department's precedent with respect to the importance of achieving and maintaining an A bond rating. Boston Gas Company, D.P.U. 88-67, p. 195 (1998); Commonwealth Electric Company, D.P.U. 88-135/151, p. 127 (1998).

118; Blackstone Gas, D.T.E. 01-50.[48] First, Berkshire has been aggressive and successful in its resource planning. The comprehensive and successful DSM programs administered by the Company (see e.g., Berkshire Gas, D.T.E. 01-29; Berkshire Gas, D.P.U. 96-92) and the planning efforts (including load management and targeted DSM) to initially defer the need for a new resource and to then develop the flexible, least cost LNG facility, have been exemplary. Exh. BG-1, p. 11; Exh. AG 12-17; Exh. BG-27. (In addition, an expensive new tank will be constructed shortly at the facility and its costs will not be reflected in the rates. Exh. BG-22, p. 8.) The creative use of asset managers and alliance structures for the benefit of customers similarly merits recognition. See Berkshire Gas, D.T.E. 99-81; Berkshire Gas, D.T.E. 01-41.

In addition, Berkshire has recognized its role as an important employer in western Massachusetts and fully embraced all recent substantial policy initiatives of the Department. First, the Company established a holding company structure to secure greater structural and functional separation. See Berkshire Gas, D.T.E. 98-61/87 (1998). Second, the Company has been a leader in terms of its efforts to assist low-income customers. See LEAN In. Br.; LEAN Rep. Br. Third, the Company has actively embraced competition and unbundling, working actively to facilitate market development, including to be the first regional utility to establish electronic data interface with marketers. Fourth, the Company has accepted the challenges associated with the Department's directives to adopt PBR and price-cap strategies. See Section II, supra. The assumption of this added risk by a small utility in a relatively stagnant service area is notable. As part of its assumption of PBR-related risk, the Company has incorporated, without qualification, the requirements of the new Service Quality Guidelines. See Section II. B., supra.

[48] Again, Berkshire's equity ratio of 43.9% is below the assumed 50/50 ratio applied to Blackstone. Compare Co. In. Br., p. 130; Exh. BG-10, p. 20 and Blackstone Gas, D.T.E. 01-50, p. 25.

In contrast to companies that have not yet embraced PBR, Berkshire's willingness to assume greater risk should be appropriately balanced by an opportunity to earn a higher return.

The Company believes that these enthusiastic and aggressive responses to Department policy initiatives should be considered in establishing the rate of return.

2. DCF Model

The Attorney General begins his criticism of Mr. Moul's application of the DCF model by setting forth an incomplete and therefore misleading description of it. AG Rep. Br., p. 39. As Mr. Moul explained in his pre-filed testimony:

> Because stocks are not held by investors forever, the growth in the share value (i.e., capital appreciation, or capital gains yield) is most relevant to investors' total return expectations. Hence, investor expected returns in the equity market are provided by capital appreciation of the investment as well as receipt of dividends. As such, the sale price of a stock can be viewed as a liquidating dividend which can be discounted along with the annual dividend receipts during the investment-holding period to arrive at the investor expected return.

Exh. BG-11, pp. E-10-E-11. Additionally, Mr. Moul explained:

> In its constant growth form, the DCF assumes that with a constant return on book common equity and constant dividend payout ratio, a firm's earnings per share, dividends per share and book value per share will grow at the same constant rate, absent any external financing by a firm. Because these constant growth assumptions do not actually prevail in the capital markets, the capital appreciation potential of an equity investment is best measured by the expected growth in earnings per share. Since the traditional form of the DCF assumes no change in the price-earnings multiple, the value of a firm's equity will grow at the same rate as earnings per share. Hence, the capital gains yield is best measured by earnings per share growth using company-specific variables.

Exh. BG-11, p. E-10.

In addition, Professor Myron Gordon, the foremost proponent of the DCF, determined that analysts' forecasts of earnings growth are the best measure of the growth component of the DCF.

See Co. In. Br., p. 146; Tr. 5, pp. 659-60. Moreover, with the projected decline in the dividend payout ratio, see Exh. BG-10, p. 33, it would be wrong to use the dividend growth rate because the constant price-earnings multiple assumption of the DCF mandates that earnings per share growth will produce the growth rate expected by investors.

With that background, the Attorney General accuses Mr. Moul of "myopic view" and of placing "100% reliance on short-term earnings forecasts" over long-term forecasts. AG Rep. Br., pp. 40-41. The Attorney General, however, has no basis for claiming that the earnings projections used by Mr. Moul (i.e., IBES, Zacks, First Call, Market Guide and Value Line) are "short-term" projections, since Mr. Moul used the longest possible growth rates that influence investor expectations, the five-year forecasts that Dr. Myron Gordon found to represent the best measure of growth in the DCF model. See Co. In. Br., p. 146; Tr. 5, pp. 659-60. These growth rates are not just for the one or two years that would be characteristic of "short-term." In order to synchronize the growth rate with the price of stock that is used in the dividend yield calculation, the analysts' forecast of earnings per share growth must be used to conform with the expectations of investors who determined the price of the stock.

Moreover, as shown exhaustively in the Company's Initial Brief, the forecast of growth in the overall economy (i.e., nominal GDP growth), which is what the Attorney General persists in comparing Mr. Moul's results to, see AG Rep. Br., pp. 39-40, simply has no place in the DCF growth rate determination. Co. In. Br., p. 147; Tr. 5, pp. 658-59.

While the Attorney General states the Company has proposed the Department simply ignore historical growth rates in performing the DCF analysis, AG Rep. Br., p. 40, in fact these values have already been incorporated into the analyst's forecasts. Analysts obviously do not make their forecasts in a vacuum but instead begin by apprising themselves of the relevant historical performance. Analysis of a firm begins with its historical performance, which serves as a foundation for projections of future performance.

With regard to the Attorney General's complaint that Mr. Moul inappropriately "cleans[es]" statistical data by eschewing historical data containing negative growth rates, AG Rep. Br., p. 40, Mr. Moul cogently explained that "[r]ational investors always expect positive returns, otherwise they will hold cash rather than invest with the expectation of a loss." Exh. BG-10, p. 32. The negative growth rates that the Attorney General advocates would channel capital away from Berkshire, since opportunities for positive returns are available elsewhere. Incorporating negative returns in the Company's cost of capital would deny the Company the ability to attract capital, which Bluefield and Hope mandate as a condition of a fair rate of return.

With respect to the Attorney General's argument that a portion of the Company's Initial Brief should be stricken, AG Rep. Br., p. 40, it in fact is portions of the Attorney General's own briefs concerning the growth in nominal GDP that should be stricken. The Attorney General provides no record citation whatsoever in either his Initial Brief or his Reply Brief in support of his proposal to use nominal GDP growth in the DCF. AG In. Br., p. 47; AG Rep. Br., p. 40.[49] Indeed, the only material in the record bearing on the issue is Mr. Moul's testimony before the Department, which establishes that long-term GDP growth has no bearing on the DCF growth rate. Tr. 5, pp. 658-59. Unfortunately, attempting to make this argument without record support appears to be nothing new for the Attorney General: very recently, the Department had occasion to note that the Attorney General had "not sufficiently supported his application of the GDP

[49] The Attorney General's citation to AG-RR-7, p. 14 in his Initial Brief is simply a citation to the Table of Long-Range Consensus U.S. Economic Projections appearing in the October 10, 2001 edition of Blue Chip Economic Indicators; the source does **not** provide support for the proposition that nominal GPD growth should be used for purposes of the DCF analysis.

growth rate in determining an appropriate R[eturn] O[n] E[quity]." Fitchburg, D.T.E. 99-118 (2001), p. 83. Here, as in Fitchburg, the Attorney General has developed no record that would justify the use of growth in nominal GDP in the DCF model. Finally, the Company's Initial Brief dispenses with the potpourri of growth rates proposed by the Attorney General in his attempt to understate investor expectations in the context of the DCF. Compare AG Rep. Br., p. 40, with Co. In. Br., pp. 145-48.

Finally, the Attorney General's attempt to denigrate the forecasts as prepared by "stock brokers and investment houses whose interest it is to peddle the very products which they are 'analyzing'," AG In. Br., p. 41, is totally misplaced. First, the IBES, Zacks, First Call and Market Guide forecasts represent a consensus of all analysts following these securities from both the buy-side and sell-side. A consensus in this regard removes any bias in the forecasts by analysts. Second, the Value Line forecasts are not prepared by either a stock broker or an investment house, so Value Line is not peddling its products to the companies that it covers. Indeed, under the Attorney General's standard, Value Line should be the most objective source of forecast growth. Since AG-RR-10 reveals that Value Line has the highest forecast growth in earnings (9.15%), the consensus of analysts' forecasts by IBES (7.00%), Zacks (7.34%), First Call (7.03%) and Market Guide (7.17%) are a priori reasonable because they are more conservative than the "more objective" Value Line forecasts.

In sum, none of the Attorney General's arguments regarding Mr. Moul's use of the DCF model withstands scrutiny.

3. Risk Analysis and Risk Adjustments

The Attorney General repeats in his Reply Brief his assertion that the non-utility businesses have increased the risk for Mr. Moul's Barometer Group companies. AG Rep. Br., p.

41. As noted in the Company's Initial Brief, however, each of Mr. Moul's Barometer Group companies is viewed primarily as a gas distribution utility. Co. In. Br., p. 161. The Attorney General's rank speculation that non-utility businesses are probably the single most important factor that investors consider is wholly unsupported in the record. Instead, as noted, the record shows that the focus of investors, and hence the appropriate focus of this inquiry, is on the utility sides of these businesses.

Moreover, even assuming arguendo that non-utility businesses are important to investors, the record evidence does not support the Attorney General's assertion that these businesses necessarily increase the risk for these companies. See, e.g., Tr. 5, p. 655 (whether non-regulated business decreases or increases firm's risk depends on circumstances). Accordingly, the Attorney General's assumption of a 20% return on unregulated subsidiaries is doubly flawed, first because the record does not support the proposition that unregulated subsidiaries have more risk, and second because the record does not support the particular 20% figure that the Attorney General has pulled out of thin air. Indeed, the Attorney General's entire effort to demonstrate the purported effect of the Barometer Group's unregulated businesses on the cost of equity should be stricken and ignored by the Department. This is particularly so since only three companies in Mr. Moul's Barometer Group are engaged in oil and gas exploration, see DTE-RR-13, and thus a return of 14% or 15% is at least as plausible as the Attorney General's made-up figure. The bottom line is that determining the Company's return on equity based on make-believe hypotheticals would be completely antithetical to sound public policy and fundamental fairness.

In addition, the Attorney General has no record support indicating that the profit margin (revenues less costs) contributes in the same way as the revenues of regulated and unregulated business. For example, eight of Mr. Moul's eleven Barometer Group companies are engaged in gas marketing and energy services, see DTE-RR-13, a business that operates on extremely thin margins. As a consequence, the 69% of gas distribution revenues compared to total revenues of these companies, see id., cannot be taken to represent the relative profit contribution of each. Hence, even if the Attorney General's fictitious 20% return were appropriate for these endeavors, they may contribute only 5% to a company's profit. Under the Attorney General's unsupported hypothetical, the 13.1% overall cost of equity would provide a fall-out 12.7% (20% x .05 = 1.0%; 13.1% - 1.0% = 12.1% ÷ .95 = 12.7%) regulated return. If the return on these businesses were 15%, then the fall-out return on the regulated utility would be 13.0% (15% x .05 = 0.75%; 13.1% - 0.75% = 12.35% ÷ .95).

This all goes to show that the Attorney General is merely engaged in a numbers game that has no support in the record and hence provides no probative value to this proceeding. The Department should reject the Attorney General's sophistry in this regard because it detracts from, rather than contributes to, a well-reasoned and fair determination of the Company's cost of equity.

4. Conclusion

The Attorney General closes this section of his reply brief by claiming that his proposed 9.84% return on equity should be adopted by the Department. As shown supra, however, this rate of return, far from satisfying the standards of Hope and Bluefield, instead would threaten to push the Company into "junk bond" status and hence imperil its ability to attract capital on reasonable terms. It is critical to keep in mind that, under the PCM Plan, the Department's decision regarding return on equity will have a profound effect on the Company's finances for the next ten years. Accepting the Attorney General's proposal, or anything remotely close to it, would almost certainly be disastrous. Instead, the Department should adopt the 12.5% return on equity that Mr. Moul's well-reasoned and well-documented analysis supports.

IV. RATE DESIGN

A. <u>The Company's Proposed Use of the MBA Allocator Will Yield a More Equitable Rate Design</u>

The Company's Initial Brief demonstrated that the Company's application of the Market Based Allocator ("MBA"), developed and supported by its expert witness, Mr. James Harrison, in order to allocate gas production costs and, in future filings, to develop load-factor based CGA rates, should be accepted by the Department. Co. In. Br., pp. 178-186. The Company demonstrated that the application of the MBA was consistent with Department precedent (both as to cost allocation and the assignment of capacity), resulted in a superior pricing structure and reduced harmful "cherry picking" of customers by marketers. The Company also demonstrated that the MBA methodology had been implemented successfully for other utilities. The Company also dismissed the arguments of the Attorney General in his Initial Brief. <u>Id</u>.

In his Reply Brief, the Attorney General revisits certain of his discredited arguments. The Attorney General's initial reply argument is the asserted need for a generic review of allocation techniques. The Attorney General distorts the Company's arguments with respect to this matter. AG Rep. Br., pp. 34-35. The Company noted that this is the fifth case in which the MBA allocator has been presented to the Department. Co. In. Br., pp. 178-79. The Company appreciates that in only one case has the MBA allocator been adopted in an adjudicated decision, namely Fitchburg Gas. D.T.E. 98-51.[50] The Company simply has demonstrated that, given the fact that now five base rate proceedings have investigated the MBA, no generic reconsideration of these cases is necessary.

The Attorney General then revisits his discredited argument that the MBA is too complex and may not be efficiently reviewed during CGA proceedings. AG Rep. Br., p. 35. Again, the MBA is now employed by several other utilities, the methodology has been subject to extensive review and consideration in this proceeding and the more simple application of the approach will be subject to Department review. Co. In. Br., pp. 178-80. Given this record of successful implementation, the Attorney General's arguments can be readily dismissed.

The Company has demonstrated that the MBA proposed in this proceeding is consistent with established precedent and Department policy and will establish more appropriate gas price signals. The Company has demonstrated that the Attorney General's criticisms of the MBA are misguided and his suggested generic process is unnecessary. Accordingly, consistent with the Department's findings in Fitchburg Gas, D.T.E. 98-51, the Company respectfully requests that the Department accept the Company's proposed MBA allocator.

[50] The Attorney General disregards record evidence when he argues that the Department did not accept the MBA allocation methodology. AG Rep. Br., p. 34. As Mr. Harrison explained, the MBA approach presented in this case was essentially **identical** to that proposed in the Fitchburg Gas case and adopted by the Department. Co. In. Br., p. 180.

V. CONCLUSION

The Berkshire Gas Company respectfully submits that the Department should find that its PCM Plan, related calculation of revenue requirements and related rate design proposals are supported by the evidence presented in this proceeding, relevant Department precedent and sound principles of public policy. The Department should reject the arguments and adjustments proposed by other parties, except as noted herein and in the Company's Initial Brief. Accordingly, the Company respectfully requests that the Department make all findings of fact and rulings of law that are necessary and appropriate to determine that the PCM Plan and the proposed rate schedules are reasonable and appropriate and order the implementation of rate schedules for existing and new service that are consistent with the Company's proposals in this proceeding.

Respectfully submitted,

THE BERKSHIRE GAS COMPANY

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ATTACHMENT A

UPDATED COST OF SERVICE GUIDELINES